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In the Supreme Court of the United States

OCTOBER TERM, 1989

MAYLEE DUBOIS and VITOUSEK & DICK REALTORS, INC.,

Petitioners,

v.

GERALD HOCKING,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

Whether the resale of a condominium apartment in a resort complex to a buyer who elects shortly following the purchase to enter into a rental service agreement (which includes a rental pool in the future) with a third party constitutes an *investment contract* and hence a *security* under Section 3(a)(10) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78c(a)(10), where (i) a real estate broker informs the buyer of, and assists the buyer in applying for, the rental services, (ii) the rental service agreement is terminable by the buyer on short notice, and thereafter the buyer obtains complete use of and control over the condominium, (iii) the rental services are provided by a third party having no affiliation or selling arrangement with the seller or broker, (iv) the seller has no communications with the buyer, and the broker has no authority to offer the third party's rental services or make any commitment with respect thereto, (v) the seller is not a participant in any rental pool or similar arrangement, and (vi) the buyer purchases the condominium with the hope of short-term appreciation in market value, but also has a stated need for rental income to service the carrying cost of the condominium.

LIST OF PARTIES*

In addition to the named parties, the following parties filed *amicus curiae* briefs in connection with the rehearing *en banc* before the Court of Appeals for the Ninth Circuit: (1) United States Securities & Exchange Commission; (2) National Association of Realtors; (3) Hawaii Association of Realtors; and (4) Hotel Corporation of the Pacific, Ltd.

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* Per Rule 28.1, names of all parent companies, subsidiaries (except wholly owned subsidiaries) and affiliates of Vitousek & Dick Realtors, Inc., corporate Petitioner: none.

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B. Order dated December 7, 1988 Withdrawing Original Decision of the Court of Appeals for the Ninth Circuit

C. Original Decision of the Court of Appeals for the Ninth Circuit dated February 10, 1988

D. Order of the United States District Court for the District of Nevada, dated March 20, 1985

E. Text of Section 3(a)(10) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. Section 78a(c)(10)

F. Securities Act Release No. 33-5347, 17 C.F.R. 231, 38 Fed. Reg. 1735, 1 Fed.Sec.L.Rep. (CCH) 1049 (Jan. 4, 1973)

G. *Amicus Curiae* Brief of Securities & Exchange Commission Filed in Connection With Rehearing *En Banc* in Ninth Circuit

H. Order dated August 1, 1988 by the Ninth Circuit that the Original Decision of the Court of Appeals be Reheard by the *En Banc* Court

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The Petitioners Maylee Dubois and Vitousek & Dick Realtors, Inc. respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit, sitting *en banc*, entered in the above-entitled proceeding on September 21, 1989.

OPINIONS BELOW

The divided *en banc* opinion of the Court of Appeals for the Ninth Circuit reversing and remanding the case to the District Court is reported at 885 F.2d 1449 (9th Cir. 1989), and is reprinted in the Appendix hereto.

The divided opinion of the three-judge panel for the Court of Appeals for the Ninth Circuit reversing and remanding the case to the District Court is reported at 839 F.2d 560 (9th Cir. 1988), and is reprinted in the Appendix

hereto. An order withdrawing this opinion is reported at 863 F.2d 654 (9th Cir. 1989), and is reprinted in the Appendix hereto.

The memorandum decision of the United States District for the District of Nevada (Howard D. McKibben, J.) granting summary judgment in favor of Petitioners has not been reported. It is reprinted in the Appendix hereto.

JURISDICTION

The jurisdiction of the United States District Court for the District of Nevada was invoked pursuant to Section 27 of the Securities Exchange Act of 1934, as amended (the *"Exchange Act"*), 15 U.S.C. § 78aa. On March 21, 1985, the District Court granted Petitioners' joint motion for summary judgment. See Appendix.

On Respondent's appeal, a divided three-judge panel of the Ninth Circuit on February 10, 1988 entered a judgment and opinion reversing and remanding the case to the District Court for further proceedings. See Appendix. This opinion was subsequently withdrawn by order of December 7, 1988. See Appendix.

On February 23, 1988, Petitioners filed a petition for rehearing *en banc* with the Court of Appeals for the Ninth Circuit, and on August 1, 1988 the Court of Appeals entered an order that the case be reheard *en banc* pursuant to Circuit Rule 35-3. This order is reported at 852 F.2d 503 (9th Cir. 1988) and is reprinted in the Appendix.

On September 21, 1989, a divided decision of the Court of Appeals for the Ninth Circuit sitting *en banc* was entered which reversed and remanded the case to the District Court. See Appendix.

The jurisdiction of this Court to review the decision of the Ninth Circuit is invoked under 28 U.S.C. § 1254(1). This petition is timely filed within ninety days thereafter as required under 28 U.S.C. § 2101(c).

STATUTES INVOLVED

15 U.S.C. §§ 78c(a)(10) and 78j(b) [Sections 3(a)(10) and 10(b) of the Exchange Act], and Rule 10b-5, 17 C.F.R. 240.10b-5, promulgated under Section 10(b) of the Exchange Act

Section 3(a)(10) of the Exchange Act provides, in pertinent part, that "[t]he term "security" means any .... investment contract ...." See Appendix.

Section 10(b) of the Exchange Act provides as follows:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

"(b) to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Pursuant to the authority granted under Section 10(b) of the Exchange Act, the SEC adopted Rule 10b-5, 17 C.F.R. 240.10b-5, which provides as follows:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

"(a) to employ any device, scheme, or artifice to defraud,

"(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in

order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

The analysis of whether or not an investment contract is present in this case is influenced by an interpretive release adopted by the Securities & Exchange Commission (*"SEC"*) in 1973 (the *"1973 Release"*), Securities Act Release No. 33-5347, 17 C.F.R. 231, 38 Fed. Reg. 1735, 1 Fed.Sec.L.Rep. (CCH) ¶ 1049 (Jan. 4, 1973), which is reprinted in the Appendix hereto. In addition, the views and opinion of the SEC with respect thereto and with respect to whether this case involves an *investment contract* are set forth in the SEC's *amicus curiae* brief filed in connection with the rehearing *en banc* in this case. The SEC's *amicus* brief is reprinted in the Appendix hereto.

STATEMENT OF THE CASE

The Facts

Respondent, Gerald Hocking (*"Hocking"*), brought suit against Petitioners in the United States District Court for the District of Nevada in 1983 alleging violations of Section 17(a) of the Securities Act of 1933, as amended (the *"Securities Act"*), 15 U.S.C. § 77q(a), and Section 10(b), 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5, under the Exchange Act in connection with Respondent's purchase of a condominium and entry into a rental pool arrangement relating thereto. Federal court jurisdiction was invoked under Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a), and Section 27 of the Exchange Act, 15 U.S.C. § 78aa. The claims under Section 17(a) were subsequently dismissed, and only the claims under Section 10(b) and Rule 10b-5 remain.

Hocking, a Nevada resident, purchased a resort condominium apartment in Honolulu, Hawaii, from Tovik Naftali

Liberman and Yaacov Liberman, the individual owners, pursuant to an agreement of sale dated June 23, 1979 (the *"Sale Agreement"*). Hocking had enlisted the assistance of Petitioner Maylee Dubois (*"Mrs. Dubois"*), a licensed real estate agent in Hawaii employed by Petitioner Vitousek & Dick Realtors, Inc., to help him find such a condominium, and shortly thereafter Mrs. Dubois informed Hocking that a condominium apartment owned by the Libermans in a complex originally developed by Aetna Life Insurance Company was available for sale. Hocking thereafter proposed to purchase the condominium through a three-party tax-deferred exchange involving three vacant lots in Nevada he then owned; however, the tax-deferred exchange was subsequently abandoned, and the parties proceeded with a straight purchase by Hocking from the Libermans. Hocking personally viewed the condominium in May 1979, and the purchase was consummated on June 23, 1979 pursuant to the Sale Agreement.

The Sale Agreement makes ***no mention of and has no requirement*** concerning a rental agency or rental pool agreement, arrangement or understanding. The Libermans had no participation in, and were not parties to, any rental arrangement relating to the condominium. ***The Libermans never spoke to or otherwise communicated with Hocking,*** and as such made no representations or offers to him concerning rental of the condominium.

Hocking contends that Mrs. Dubois induced him to enter into the Sale Agreement, and that in doing so she offered to him and included as part of the purchase and sale of the condominium a rental arrangement or rental pool arrangement (referred to herein as *"RPA"*) relating to the condominium with emphasis on the economic benefits to Hocking to be derived from the managerial efforts of third parties designated or arranged for by Mrs. Dubois from rental of the condominium. The RPA was with a company called Hotel Corporation of the Pacific, Ltd. (*"HCP"*). Hocking contends that Mrs. Dubois informed him of the availability of rental services with regard to the condominium, but he admits that she did not make any representations to him concerning how

much money on a monthly basis he could expect to receive as rent (although he does allege that he was informed by her that other condominiums in the complex were renting at an average of $100 per day).

Neither the Libermans, Mrs. Dubois, nor Vitousek & Dick had any affiliation or selling arrangement with HCP, and none of them had any authority to offer HCP's services or bind HCP to provide its services.

Within a few weeks following the closing of Hocking's purchase of the condominium, Hocking entered into two rental-related agreements with HCP: (1) a Rental Management Agreement (the *"Rental Management Agreement"*) pertaining only to Hocking's condominium, and ***not*** providing for the pooling of any revenues or expenses from or of any other condominium apartments; and (2) the Individual Agency Rental Agreement for Pooled Operation (the *"Pooling Agreement"*) and an addendum thereto (the *"Addendum"*)—under the Pooling Agreement, revenues and expenses from rental of several condominium apartments in the same complex would be pooled together, and the individual condominium owners would be entitled to share in the profits from the pooled operations; however, under the express terms of the Addendum to the Pooling Agreement, HCP and Hocking agreed that all of the rental pool provisions of the Pooling Agreement would be waived until the earlier of the developer's sale of all the units in the complex or December 31, 1982.

The Rental Management Agreement contained ***no prohibition or restriction whatsoever on Hocking's right to use or occupy his condominium at any time,*** and could be ***terminated by either Hocking or HCP at any time for any reason upon thirty days' written notice.*** The Pooling Agreement could be ***terminated by Hocking for any reason at any time during the first year upon fifteen days' notice and thereafter ninety days prior to each anniversary date,*** permitted Hocking to ***occupy the unit*** if it had not otherwise been committed to another person, and permitted Hocking to ***arrange for the rental of his own unit.***

Hocking's intention in purchasing the condominium was to hold it for a short period of time and resell it at an appreciated price. Hocking hoped that the rental proceeds would be sufficient to cover the monthly debt service.

In approximately June 1982, when a balloon payment under the Sale Agreement was due and after having made monthly interest payments for three years, Hocking failed to make the balloon payment and hence lost the condominium.

Hocking alleges two misrepresentations by Mrs. Dubois relating to his purchase of the condominium: (1) an allegedly false representation that Hocking would be the first purchaser from the developer of the condominium, when, in fact, he was not, and (2) an allegedly false representation that the condominium had a market value greater than its cost to Hocking.

Grant of Summary Judgment by District Court

The District Court held that the condominium and RPA did not involve the sale of an *investment contract* and hence a security, and granted Petitioners' motion for summary judgment on the securities claims (after allowing Hocking to thrice amend his complaint). In its analysis, the District Court applied the three-prong test adopted in the Supreme Court's seminal decision *SEC v. W.J. Howey*, 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946), and the views of the SEC as articulated in the 1973 Release.

The District Court concluded that Hocking's purchase did not involve an *investment contract* because, among other reasons, the purchase was not conditioned upon his participation in any RPA, the Libermans were not involved in any RPA, Hocking freely elected to enter into the RPA when there was no requirement in the Sale Agreement or otherwise to do so, and Hocking was not restricted from the use of his unit.

The Majority Opinion in the Original Ninth Circuit Decision

On appeal to the Court of Appeals for the Ninth Circuit, the panel majority, in a divided decision, concluded that the

SEC's 1973 Release was ***controlling and created an automatic bright-line rule of law for all cases*** that the offering of a participation in a rental pool arrangement ***automatically*** makes an investment an investment contract and hence a security. 839 F.2d at 565.

The panel majority went on to hold that, even apart from the 1973 Release, the offer of the condominium satisfied the three prongs of the *Howey* test: i.e., an (1) investment of money, (2) in a common enterprise (3) with the expectation of profits produced by the efforts of others. 839 F.2d at 564; *Howey, supra,* 328 U.S. at 298-99, 66 S.Ct. at 1103. In analyzing these three prongs, the panel majority held with respect to the third prong (which is the focus of this petition) that an expectation of profits produced by the efforts of others exists *"whenever* a condominium is sold with a [rental pool] option." *Id.* (emphasis in original).

The Dissenting Opinion in the Original Ninth Circuit Decision

Judge Hugg dissented in the original Ninth Circuit decision because he did not believe that the federal securities laws extended *"to this attenuated transaction."* 839 F.2d at 560 (emphasis added). He found it significant that the Libermans lacked any authority to commit Aetna or HCP to a rental pool arrangement or even offer their services with regard thereto, and that they were not themselves parties to an RPA. The Libermans "bought a parcel of real property. That is all they were selling—a parcel of real property." *Id.* at 571. ***"[A] broker who simply arranges for the sale of the [condominium] unit and notifies the buyer that he may be able to enroll in the developer's rental pool is not offering a security. This is a real estate transaction and is properly governed by real estate law."*** *Id.* (emphasis added). Judge Hugg believed that the panel majority's opinion was incorrectly based on the unsupported premise that there existed a genuine issue of material fact as to whether or not the offer from the Libermans which was communicated to Hocking included an option to participate in the rental pool operated by HCP.

Judge Hugg also believed that the SEC's 1973 Release was intended to notify ***developers*** of a bright-line rule when

they must register their projects with the SEC. *Id.* at 572. (The SEC subsequently indicated a view in its *amicus* brief that the 1973 Release applies only to developers and others in the real estate business. See Appendix.)

The SEC's *Amicus Curiae* Brief

In connection with the rehearing *en banc*, the SEC filed an *amicus curiae* brief stating the opinion that this case does not involve an *investment contract*. The SEC analyzed both *Howey* and the 1973 Release, and concluded that the original panel majority:

> "[I]mproperly construed the reach of [the federal securities] laws in a case involving the sale of residential real estate. ***The Commission is particularly concerned because the panel reached its decision based in considerable part upon a misunderstanding of the Commission's position as stated in a 1973 Commission release.***" (Emphasis added.)

According to the SEC: ***"Unless there is a link between the seller of the property (or his agent) and the provider of services, these are two separate transactions [i.e., Hocking's purchase of the condominium and entry into the RPA], and the property sale is not covered by the securities laws."*** (Emphasis added.)

The Majority Opinion in the *En Banc* Decision by the Ninth Circuit

Judge Goodwin, writing for the majority in the *en banc* decision, **refused to give any special weight to the SEC's views as expressed in its *amicus* brief, contending that the SEC had inconsistently interpreted its 1973 Release and lacked any case authority supporting the position in its *amicus* brief.** 885 F.2d at 1458-59 n.7.

In applying *Howey's* investment contract analysis to this case, the majority first considered the fact that Mrs. Dubois could not legally offer or bind HCP to enter into an RPA with Hocking since she had no affiliation or selling arrangement with HCP, and did not otherwise have the authority to do so. The majority overcame this hurdle by adopting a new

test under the securities laws—the ***presented as part of the same transaction*** test: ***"It is enough if the items were presented to Hocking as part of the same transaction or scheme, and that he purchased them as such."*** *Id.* at 1458.

The majority next considered and rejected the argument that the offering of the condominium and the RPA were two separate and distinct offers by different parties. *Id.* at 1459.

The majority also rejected the position that the third prong of the Howey test could not be met (1) where ***Hocking was not required to enter into the RPA as a prerequisite to purchasing the condominium,*** but instead voluntarily elected to put it into HCP's hands, and (2) Hocking had the right to terminate the RPA on short notice and as such take back control of the condominium. *Id.* at 1460. In rejecting these arguments, the majority attempted to distinguish two Eighth Circuit decisions involving the purchase of apartment buildings with related management agreements, and which stand for the legal proposition that where management control over real estate is ***voluntarily delegated*** by a buyer or can be ***reacquired by the buyer on short notice*** by cancelling the management agreement, the third prong of *Howey* is not satisfied. *Fargo Partners v. Dain Corp.*, 540 F.2d 912, 915 (8th Cir. 1976); *Schultz v. Dain Corp.*, 568 F.2d 612 (8th Cir. 1978). The majority reasoned that in both cases the purchasers were buying entire apartment buildings and were presumably sophisticated, and hence "[t]he absence of any legal requirement to delegate control in *Fargo Partners* and *Schultz* amounted at the same time to the absence of any practical need to delegate control. As an inexperienced, non-resident, individual investor Hocking is different from Schultz." *Id.*

In addition, the majority clung to its belief that the third prong of *Howey* was satisfied in this case despite the several other appellate and lower court cases cited by Petitioners for the legal proposition that a purchaser's voluntary election to delegate control or the purchaser's ability to regain control on short notice nullifies the third prong of *Howey* and hence takes the case outside the federal securities laws. *Id.* at 1460;

see, e.g., *Gordon v. Terry*, 684 F.2d 734, 741-42 (11th Cir. 1982), cert. denied, 459 U.S. 1203, 103 S.Ct. 1188 (1983) (investment in several real estate syndications); *Williamson v. Tucker*, 645 F.2d 404, 421 (5th Cir.), *cert. denied*, 454 U.S. 897, 102 S.Ct. 396, 70 L.Ed. 212 (1981) (real estate joint venture transaction); *Crowley v. Montgomery Ward & Co., Inc.*, 570 F.2d 877, 880-81 (10th Cir. 1978) (catalog sales agency transaction); *Ballard & Cordell Corporation v. Zoller & Dannenberg Exploration, Ltd.*, 544 F.2d 1059, 1065 (9th Cir. 1976), *cert. denied*, 431 U.S. 965, 97 S.Ct. 2921, 53 L.Ed.2d 1060 (1977) (oil and gas transaction); *Deutsch Energy Co. v. Mazur*, 813 F.2d 1567, 1570 (9th Cir. 1987) (oil and gas transaction); *Perry v. Gammon*, 583 F.Supp. 1230 (N.D. Ga. 1984) (sale of apartment complexes).

Finally, the majority discussed the case of *Williamson v. Tucker*, 645 F.2d 404 (5th Cir.), *cert. denied*, 454 U.S. 897, 102 S.Ct. 396, 70 L.Ed. 212 (1981), as the leading case on the "control" issue within the context of the dependency question under the third prong of *Howey* (i.e., whether the control delegated to the third party, i.e., HCP in this case, renders the purchaser dependent on the efforts of others for profit as contemplated by the third prong of *Howey*). The majority found that a genuine issue of material fact was presented concerning whether the third prong of *Howey* (as applied by *Williamson*) was satisfied based on (1) Hocking's claim that he was an unsophisticated and inexperienced investor interested in making a passive investment from a great distance and (2) the question whether Hocking had any viable and practical alternative to using the rental services of HCP. *Id.* at 1461.

The Five-Member Dissenting Opinion in the *En Banc* Decision

Judge Norris wrote for five dissenting members of the *en banc* panel, who agreed unequivocally with the SEC's view that **"in the absence of probative evidence of some affiliation or selling arrangement between the Libermans (or their agent Dubois) and the manager of the rental pool, the condominium sale did not involve the sale of a security because Hocking's contract to participate in the rental pool was a separate**

transaction." *Id.* at 1463 (emphasis added). The dissent expressed great concern that the majority's new test would inappropriately **"spawn litigation under the federal securities laws whenever a similar buyer becomes disappointed with the economic return he realizes from his condominium and RPA."** *Id.* (emphasis added).

The dissent stated that a purchase of the type made by Hocking does not become a securities transaction "when the purchaser independently procures management services from others." *Id.* at 1464. Also, the dissent believed that the SEC's views should be accorded considerable deference and given great weight in this case:

> "The SEC's position sensibly limits the reach of the federal securities laws by excluding sales of individual condominium units where the seller (or his agent) has no connection with anyone who provides management services, while at the same time including cases in which the seller is affiliated with the provider of management services." *Id.* at 1465 n.11.

With regard to the majority's *presented as part of the same transaction* test, the dissent wrote that:

> "The majority's test is ***so standardless*** that unwary realtors who do nothing more than advise prospective condominium purchasers about the availability and economics of an RPA will find themselves in federal court defending actions brought under the federal securities laws on the authority of the decision in this case." *Id.* (emphasis added).

The dissent was also critical of, and in disagreement with, the majority's reliance on Hocking's assertion that without the rental agreements he would not have entered into the transaction. The dissent believed that the majority's reliance was misplaced inasmuch as ***Hocking's subjective state of mind is not relevant to the question of whether Mrs. Dubois offered a security.*** *Id.* at 1446.

Finally, the dissent strongly disagreed with the majority's claim that the "essentially one transaction" language in *Black-*

well v. Bentsen, 203 F.2d 690 (5th Cir.), *cert. dismissed*, 347 U.S. 925 (1953), supports the majority's *presented as part of the same transaction* test. In *Blackwell* there was a clear affiliation between the seller of the real estate and the seller of the management services (i.e., both companies were owned by the same people), whereas in the present case there is no such affiliation. "The majority overlooks this distinction as though it were a mere incidental fact, ***when it is critical.***" 885 F.2d at 1447 (emphasis added).

The Two-Member Dissenting Opinion in the *En Banc* Decision

The second dissenting opinion, authored by Judge Wiggins, states that the SEC's views should have been accorded ***great weight in this case.*** *Id.* at 1470. The opinion further states that given the absence of a selling arrangement or affiliation of the type described by the SEC, the offer of the condominium and the offer of the right to participate in the RPA ***must be viewed as two separate and distinct transactions;*** and, hence, the offering of the condominium does not constitute the offering of a security, whereas the separate offering by HCP of the right to participate in the RPA could well constitute in itself an offering of a security. *Id.* at 1471. Judge Wiggins also wrote:

> "If the condominium apartment is itself considered a component of the investment contract, its seller could be held liable for representations regarding its resale value even though that value has nothing to do with the 'efforts of others.' No justification exists for a resort condominium owner to have a federal remedy for losses of this sort while residential condominium owners are deprived of a similar remedy. State laws may offer protection for losses of this sort; federal securities laws are not so designed." *Id.*

Lastly, this dissenting opinion emphasizes that Hocking's theory of liability lies, for the most part, on the fact that the condominium apartment failed to appreciate in value as allegedly promised, and that appreciation in value which is dependent upon economic variables outside the control of HCP or any other third party does not satisfy *Howey's* third prong. *Id.* at 1473.

REASONS FOR GRANTING THE WRIT

The significant reasons why this Court should grant a writ of certiorari and decide this case are discussed below.

The Divided *En Banc* Decision Creates Many Conflicts, Great Confusion and Considerable Uncertainty

The *en banc* decision of the eleven-judge panel in the Ninth Circuit is a closely divided decision in which a six-judge majority, on the one hand, and a fivejudge dissent and two-judge dissent, on the other hand, seriously contradict and conflict with one another and create tremendous confusion and uncertainty for innumerable real estate transactions in determining, among other things: which legal principles are applicable in analyzing whether a real estate transaction also constitutes a securities transaction; (b) whether the SEC's interpretation and opinions as expressed in its *amicus* brief should be accorded any consideration, and whether the continued viability of the 1973 Release has been impaired; (c) whether the long settled legal principles enunciated by several Courts of Appeals for other circuits, which are in conflict with the majority opinion in the *en banc* decision, should be disregarded or followed; and (d) whether two District Court decisions based on facts nearly identical to this case should be disregarded in determining whether a real estate transaction comes within the ambit of the federal securities laws.

The New *Presented As Part of the Same Transaction* Test is Based on a Serious Misinterpretation of the Fifth Circuit's Decision in the *Blackwell* Case

The majority's opinion is based almost entirely on its *presented as part of the same transaction* test, which, as explained below, grows out of a serious misinterpretation of the Fifth Circuit's decision in *Blackwell v. Bentsen, supra.*

The absence of any affiliation or selling arrangement between the Libermans and Mrs. Dubois, on the one hand, and HCP, on the other hand, was precisely the reason for the SEC's conclusion that the sale of the condominium to

Hocking did not constitute a security. Both dissenting opinions concluded likewise for the same reason. However, the majority gave no deference whatsoever to the SEC's views, and refused to follow the ***affiliation or selling arrangement*** requirement.

All of the relevant cases cited by the majority as being consistent with its new test involved situations where there ***was an affiliation*** between the seller and the party offering the management or other service that gave rise to the investment contract issue. Moreover, in discussing the Fifth Circuit's decision in *Blackwell,* and in stating that the *Blackwell* decision supports and substantiates the *presented as part of the same transaction* test adopted by the majority, ***the majority totally disregarded that in Blackwell the real estate and management services were sold by two different companies, but that both were owned and operated by the same people.*** In the words of Judge Norris, writing for the five-member dissent:

> "The majority claims that *Blackwell's* 'essentially one transaction' language supports the majority's 'presented as the same transaction' standard, ***but it obviously does nothing of the sort.*** In *Blackwell* there was a clear affiliation between the seller of real estate and the seller of management services, whereas in this case there was none. ***The majority overlooks this distinction as though it were a mere incidental fact, when it is critical."*** 885 F.2d at 1467. (Emphasis added.)

Both dissenting opinions agreed with the SEC's view that "'**[u]nless there is a link between the seller of the property (or his agent) and the provider of services, these are two separate transactions, and the property sale is not covered by the securities laws.**' Brief of *Amicus Curiae* SEC at 10-11." 885 F.2d at 1464 (emphasis added).

If this Court allows the majority's opinion to stand, then conceivably any person selling real estate could have his sale converted into a securities transaction by the acts of third parties who provide rental, management or other similar services, even though the seller and his agents have no relationship or arrangement with the third parties. Hence,

the question whether a real estate transaction crosses the line and is deemed to involve a security may no longer be determined by what the seller (and his agents) offer, but rather by the acts of third parties having no relationship or arrangement with the seller. The majority has no precedent for such a radical deviation from the prior approach, and the real estate industry would be unfairly and improperly victimized by such a result.

The Majority Opinion in the *En Banc* Decision Is in Serious Conflict With Several Important Appellate Decisions by Several Other Courts of Appeals

If the Court allows the majority opinion to stand, it will sanction the creation of a conflict with, and serious departure from, the reasoning of and legal principles adopted by the Courts of Appeals for the Fifth, Eighth, and Eleventh Circuits.

The majority correctly recognized that the Fifth Circuit's decision in *Williamson v. Tucker, supra,* was the leading case on the control issue (i.e., whether the delegation of control to a third party rendered the purchaser dependent on the efforts of the third party for profits within the meaning of *Howey*), but incorrectly applied the legal principles and analysis of *Williamson.* The majority made an egregious error in finding that ***Hocking's own intentions and his voluntary decision to use only the services of Mrs. Dubois,*** as opposed to the acts of the Libermans and Mrs. Dubois in offering and selling the condominium to Hocking, could transform the purchase of the condominium from a real estate to a securities transaction.

The majority found that "Hocking's affidavit and deposition raise a genuine issue of fact whether ***he intended*** his investment to be entirely passive, and whether, as alleged, ***he 'relied solely on*** Dubois to select, manage, and protect' his investment." 885 F.2d at 1461 (emphasis added). The majority's reasoning, while not entirely clear, appears to have been that if Hocking had this ***intention and voluntarily chose this reliance,*** then his investment could be deemed passive and as such he could be deemed dependent on the efforts of others

for profits within the meaning of *Howey*. In the context of the analysis required by *Williamson*, the next inquiry would then be whether Hocking's right to terminate the Rental Management Agreement and the Pooling Agreement on extremely short notice was a right that provided a realistic alternative for Hocking—in this case, the majority stated the belief that such raised a genuine issue of material fact, and hence the case could not be decided on summary judgment.

The extreme error in the foregoing analysis stems from the fact that the majority allowed ***Hocking's own subjective intention*** and ***Hocking's voluntary election to rely on Mrs. Dubois*** to select, manage and protect his condominium to be determinative of whether Hocking was purchasing the condominium with an expectation of profits from the efforts of others within the meaning of *Howey*. The majority should have evaluated that question on the basis of what was being offered and sold by, and the acts and statements of, the Libermans and Mrs. Dubois.

The analysis of whether a particular transaction involves an offering of an investment contract is always based on what is being offered by the offeror and his agents; not by the purchaser's subjective intent or volitional decision to depend on others, particularly where the thing being purchased, such as the condominium here, has its own value and utility which are readily apparent and capable of being dealt with by the buyer or others. This is consistent with the Supreme Court's view expressed in *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 353 (1943), where the Court stated that an offering must "be judged as being what [it was] represented to be." **The key is not what the purchaser's beliefs were, but rather what the seller and his agents offered. In the words of Judge Norris, "I fail to see the relevance of *Hocking's* subjective state of mind to the question of whether *Dubois* offered a security."** 885 F.2d at 1466 (emphasis in original). Even in this Court's decision in *Howey*, it is evident that the Court was heavily focused on what the promoter was offering and the practical situation into which the investors were forced by the offering structured by the promoter. 328 U.S. at 299-300.

In this case, the Libermans and Mrs. Dubois offered a condominium. Hocking had the option of living in the condominium, using it as his own private getaway, making it available to family and friends, renting it out to others (either on his own or through the services of any rental company, including HCP), or doing anything else he wished with the condominium. Hocking was not stuck with only one choice when he purchased the condominium (i.e., rental through the services of HCP); rather, he voluntarily opted for rental by HCP as opposed to the many other uses and options available to him.

The majority, however, looks at this as a case where Hocking, upon purchasing the condominium, could do only one thing with it— put it into the hands of HCP for rental— when in fact that was a real ***choice*** among many that Hocking made. Such an approach in applying *Williamson* and hence in analyzing whether the third prong of *Howey* is satisfied would lead to outrageous results—buyers would thus control the determination of whether a real estate sale constitutes a securities transaction by the choices they make from alternatives available to them, even where the alternatives (such as personal use and consumption) include options that would preclude the finding of a security.

The majority opinion did not recognize that in *Williamson* the Fifth Circuit was dealing with an investor who did not have such options; rather, in *Williamson* the subject of the investment could be dealt with in only one way. Hence, the issue was whether an investor had any realistic alternatives to reliance on the managerial or entrepreneurial efforts of others in order to realize his investment. *Williamson, supra*, 645 F.2d at 424-25. However, whereas here, the subject of the investment— the condominium—has its own independent value and utility without regard to the services of a third party (such as HCP) and could, ***at the purchaser's election,*** be utilized by him as such, then the purchaser is not forced from a practical point of view to rely on the services or efforts of a third party to realize his investment.

Similarly, in *Gordon v. Terry, supra* (a case cited by the majority along with *Williamson*, but not discussed), the Court of Appeals for the Eleventh Circuit, in analyzing the

dependency element of *Howey* in the context of a real estate investment, stated as follows:

> "The fact that the investor has delegated management duties or has chosen to rely on some other party does not establish dependency. ***The investor must have 'no reasonable alternative to reliance on that person.'*** That is, the investor must be 'forced to rely on some particular non-replaceable expertise.' 684 F.2d 734, 741-42 (citations omitted).
>
> "Where representations or promises have not been made or where, if made, they do not involve claims of unique entrepreneurial or managerial abilities, the dependency required by *Williamson* cannot exist." *Id.* at 742.

As already explained, in the instant case Hocking had several perfectly ***realistic alternatives to reliance on HCP.*** He could have done any number of other things with the condominium, including use it for himself like many people do. This was not a transaction where the condominium had only one possible purpose for Hocking.

This distinction between the majority's opinion in the *en banc* decision and the *Gordon* and *Williamson* cases is of vital importance to the analysis of whether and when a real estate transaction constitutes a securities transaction. A person selling real estate which has its own independent utility and value, and which does not by necessity have to be purchased by the buyer along with a management, rental or other arrangement, should normally be outside the scope of the federal securities laws; whereas, the sale of real estate which cannot have any realistic utility to the buyer in and of itself, but which instead must by necessity be purchased together with a management, rental or other arrangement, usually will be a security. This is the essence of the Supreme Court's holding in *Howey*, where small investors throughout the United States purchased small portions of a large citrus grove in one remote location which had to be cultivated by the promoter or its affiliates as a single grove in order to have utility or value to the investors. 328 U.S. at 299-300.

As already explained, the majority's opinion in the *en banc* decision is in direct conflict with the reasoning and legal principles adopted by the Eighth Circuit in *Fargo Partners v. Dain Corp., supra, and Schultz v. Dain Corp., supra.* Both cases involved sales of apartment buildings coupled with cancellable management agreements. Both cases held that where the purchaser delegated management control of the property to a third party in connection with his purchase, but where the election to so delegate control was voluntary (i.e., the purchaser could have kept the control himself or sought another party to manage the property) and, in any event, the purchaser had the right to cancel the management contract on fairly short notice and thus regain control of the property, then there was no dependency on the efforts of others within the meaning of *Howey's* third prong.

In the instant case, Hocking could terminate both the Rental Management Agreement and the Pooling Agreement on extremely short notice, and as such he could regain total control and unimpeded access to and use of his condominium.

At a more conceptual level, this Court has recognized that the focus of the securities laws is on the unregulated sale of securities to raise capital for profitmaking purposes, and those laws do not exist for the purpose of regulating the purchase of real estate intended to be occupied by the purchaser. *United Housing Foundation, Inc. v. Forman,* 421 U.S. 837, 849 and 852-53, 95 S.Ct. 2051 (1975). While this case is different from *Forman* in that in *Forman* there was only one use of the property **permitted by the seller**—occupancy of the real estate—it is nonetheless significant that the Court in *Forman* focused very carefully on what was being sold, how it was being sold, and the fact that the buyer's use of what he was purchasing was limited by the seller (as opposed to being limited by the buyer's choice). 421 U.S. at 851, 853-54. This is the correct focus of the analysis, as opposed to the subjective intent of the buyer and the voluntary choice made by the buyer as relied on by the majority opinion in this case.

Finally, it is well settled that a real estate purchaser's expectation of appreciation in value of his real estate does

not satisfy the third prong of *Howey* where the appreciation is to come from general economic forces, as opposed to the specific activities of the seller, the developer, the property manager or the like. See, 885 F.2d at 1469. As pointed out by Judge Wiggins, "Hocking's theory of liability lies, for the most part, on the fact that the condominium apartment failed to appreciate as allegedly promised. * * * This claim is undoubtedly a matter of state law." Id. at 1473. See, *Forman, supra*, 421 U.S. at 852-53; *Grenader v. Spitz*, 537 F.2d 612 (2d Cir.), *cert. denied*, 429 U.S. 1009 (1976); *Johnson v. Nationwide Industries, Inc.*, 450 F.Supp. 948 (N.D. Ill. 1978), *aff'd*, 715 F.2d 1233 (7th Cir. 1983).

The Majority's Opinion Is in Direct Conflict With Two District Court Decisions Based on Facts Nearly Identical to This Case

The majority completely disregarded two District Court cases having facts nearly identical to the present case, but wherein the conclusions reached by both courts are directly in conflict with the majority's opinion and judgment in the *en banc* decision. In *Mosher v. Southridge Assoc., Inc.*, 552 F.Supp. 1226 (W.D. Penn. Dec. 1, 1982), and 552 F.Supp. 1231 (W.D. Penn. Dec. 21, 1982), the District Court granted the defendant/real estate developer's motion for summary judgment and motion to dismiss in a securities case with facts nearly identical to the facts of this case, reasoning that (1) the condominium purchased was not conditioned upon plaintiffs' participation in any rental program, (2) the decision to rent the condominium was within plaintiffs' sole discretion, (3) the plaintiffs, in the event they decided to rent the property, were not bound by the sales agreement to use a particular rental agent to let the property, and (4) there were no restrictions that would limit plaintiffs' right to use their unit.

Similarly, in *Dumbarton Condominium Assoc. v. 3120 Street Assoc.*, 657 F.Supp. 226 (D.D.C. 1987), the court, analyzing the principles in, among other things, *Howey*, and the SEC's 1973 Release, concluded in a case with facts very similar to the facts of this case that an investment contract was not present where (1) the purchase of the condominium

was not conditioned upon participation in a rental program, (2) there was no requirement that the purchaser use a particular rental agent, and (3) the right of the unit owner to use his unit as he pleased was not limited.

Although Petitioners cited and discussed both of these cases in their joint brief in connection with the rehearing *en banc*, the majority opinion did not cite or address either of the cases.

The Majority's Opinion Directly Conflicts With the SEC's Views, Interpretations, and Positions

The views, interpretations and positions expressed by the SEC in its *amicus* brief have been summarized earlier herein and are discussed in connection with the discussions of the majority and dissenting opinions in the decision on rehearing *en banc*. The SEC's *amicus* brief is reprinted in its entirety in the Appendix hereto.

As is evident from the discussion set forth hereinabove with regard to the SEC's views, and the analysis thereof by the majority opinion and the two dissenting opinions in the *en banc* decision, the majority opinion declined to give any deference to or to follow the views, interpretations and positions of the SEC. This decision was not only a serious error, but also was extremely dangerous because the SEC's views with regard to real estate-related securities issues, particularly those relating to the 1973 Release, have always been of crucial importance to the real estate industry. Moreover, both dissenting opinions state unequivocally that the views expressed by the SEC in its *amicus* brief are consistent with the views expressed by it in the 1973 Release, and therefore the SEC's views in the *amicus* brief should be accorded great weight.

Sellers, Buyers, Owners, Developers, Real Estate Brokers, and Many Others in the Real Estate Industry Could Suffer Unnecessary Regulation, Expense and Burdens if the Majority Opinion Stands

Once a real estate transaction is determined to involve the offer and sale of a security, then the offer and sale must

either be registered with the SEC or must be exempt from such registration requirements pursuant to an applicable exemption. See Section 5 of the Securities Act, 15 U.S.C. § 77e. Generally speaking, advertising or general solicitation or publication in offering the security (which is the normal means of offering real estate for sale) precludes the availability of an exemption from registration, and hence registration with the SEC is required. However, such registration is extremely burdensome, expensive and time-consuming, and would have a dramatically detrimental impact on the real estate industry if many of the transactions heretofore thought to be outside the scope of the securities laws were to be swept into the grasp of those laws because of the majority's unprecedented *presented as part of the same transaction test.*

Similarly, if a real estate transaction is deemed to involve the offer and sale of a security, then the brokers acting for the buyers and sellers will have to be registered as securities brokers. In the words of Judge Wiggins writing for the dissent in the *en banc* decision:

> "[T]he effect of concluding that a condominium apartment is a component of the investment contract is that neither real estate brokers who are unlicensed in the sale of securities nor securities brokers who are unlicensed in the sale of real estate can market the sale of an individual condominium apartment whose buyer is entitled to join a rental pool. See *Rosenbaum*, 60 Va. L. Rev. at 797-98. The individual owner, under these circumstances, will either have to market the unit himself, thereby defeating the stated purpose of promoting complete disclosure to potential buyers, or seek that elusive broker who was appropriately, yet needlessly, licensed in both fields. See *id.* at 801-02. Such a rule is, frankly, utter nonsense. See generally *Birman & Stone, Federal Securities Laws and the Sale of Condominiums, Houses & Home Sites*, 30 Bus. Law. 411, 412 (1975) (warning developers to 'be prepared to deal with a misapplication of the Securities Acts to the conventional offer and sale of real estate units')." 885 F.2d at 1472. [11682-83]

The majority's opinion would lead to this absurd result in far too many situations.

CONCLUSION

For these various reasons, this petition for certiorari should be granted. It bears emphasis that the *en banc* decision, which will have a very significant impact on the real estate industry, creates many uncertainties and conflicts not only because of its dramatically conflicting majority and dissenting opinions, but also because the majority departs from a large body of appellate case law from three other Circuits, is based on a serious misinterpretation of a Fifth Circuit decision, and is contrary in its reasoning, opinion and conclusion to the views and opinions of the SEC.

Respectfully submitted,

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APPENDIX A

En Banc Decision of the Court of Appeals for the Ninth Circuit, dated September 21, 1989

FOR PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

GERALD M. HOCKING,
Plaintiff-Appellant,

v.

MAYLEE DUBOIS and VITOUSEK & DICK REALTORS, INC., a Hawaii corporation,
Defendants-Appellees.

No. 85-1932
D.C. No. C-LV-83-835-HDM
OPINION

Appeal from the United States District Court
for the District of Nevada
Howard D. McKibben, District Judge, Presiding

Argued and Submitted
December 7, 1988—Pasadena, California

Filed September 21, 1989

Before: Goodwin, Chief Judge, Browning, Schroeder, Fletcher, Nelson, Norris, Wiggins, Brunetti, Noonan, O'Scannlain and Trott, Circuit Judges.

Opinion by Judge Goodwin; Dissents by Norris, joined by Wiggins, Brunetti, O'Scannlain and Trott; and Wiggins, joined by Trott.

SUMMARY

Securities

Reversing and remanding the district court's grant of summary judgment, the court held that a realtor may be subject

to the federal securities laws when a condominium sale and rental pool arrangement are both part of the same transaction.

Appellant Gerald Hocking, following a visit to Hawaii, purchased a condominium through appellee Maylee Dubois, a real estate agent, employed by appellee Vitousek & Dick Realtors, Inc., agents for the Libermans, original purchasers of the condominium from the developer. In reselling the condominium, Dubois informed prospective buyer Hocking that a rental pool arrangement run by Hotel Corporation of the Pacific was available if he were to purchase the condominium. Dubois also told him that the condominiums were renting for an average of $100 a day from which he calculated the monthly rental to be $2,000 to $3,000. According to Hocking, he relied on expected rental income to cover his monthly payments and provide additional income. While Dubois expressed no requirement that Hocking participate in the rental pool arrangement, Hocking testified that but for the availability of the RPA, he would not have purchased the condominium. Hocking sued the brokers who sold him the unit, claiming violations of the anti-fraud provisions of the Securities Exchange Act of 1934, 15 U.S.C. § 78j (1982), and Rule 10b-5, 17 C.F.R. § 240.10b-5. Hocking claimed that the loss of his investment was caused by failure to receive the expected rental income and by further misrepresentations of Dubois concerning appreciation in value of the condominium and her efforts to resell it. Hocking appealed a summary judgment in favor of appellees.

[1] In order for Hocking to make a claim under the securities laws, he must show that Dubois' misrepresentations were made in connection with the purchase or sale of a security. [2] In *SEC v. Howey Co.*, 328 U.S. 293 (1946), the Supreme Court put forward the classic definition of an investment contract. [3] There must be an investment of money in a common enterprise with an expectation of profits produced by the efforts of others. [4] Hocking claimed that by promoting the

Liebermans' condominium with an emphasis on the economic benefits to be derived from the managerial efforts of third parties designated or arranged for by Dubois and by including with the condominium an offer for a rental or rental pool arrangement, Dubois offered him a security. [5] The inability of Dubois to make a binding contractual offer of the RPA to Hocking does not mean that the RPA cannot be considered part of the package she offered him for the purposes of determining whether that package was a security under *Howey*. [6] The term "offer" has different and far broader meaning in securitites law than in contract law. It is enough if the items were presented to Hocking as part of the same transaction or scheme and that he purchased them as such. [7] Hocking has put forth numerous facts concerning whether the condominium sale and the rental agreements were presented to him as parts of one transaction. These facts distinguish this case from the everyday situation where a real estate agent or broker merely provides information to the purchaser regarding the availability of a rental pool or shared amenities such as a swimming pool or tennis court. [8] If the condominium and rental agreements were offered in one package, there can be no serious argument that Hocking did not invest money in the package. Since Hocking has created an issue of fact over whether the condominium and the RPA were sold as a package, the first *Howey* requirement has been met for purposes of summary judgment. [9] The purchase of real estate combined with an RPA evidences horizontal commonality. [10] Whether Hocking can prove horizontal commonality at trial will depend on whether he can show that Dubois offered a package which included the RPA. Hocking has raised a genuine issue of fact as to that question. [11] The third prong of *Howey* requires that Hocking must show an expectation of profits produced by the efforts of others and that these efforts are essential managerial efforts which affect the success or failure of the enterprise. [12] The *Williamson v. Tucker*, 645 F.2d 404 (1981) test requires that the economic reality of the investor's relation with the manager or promoter be exam-

ined. [13] Because Hocking has not raised facts showing that his arrangement with Dubois left him so little power as to place him in a position analogous to a limited partner, Hocking has not met the first factor suggested in *Williamson*. [14] However, Hocking has at least raised questions of fact material to the second and third suggested factors. An issue of fact exists as to Hocking's ability to manage the investment and as to the uniqueness of HCP's RPA as a method of producing income from the condominium. [15] Hocking's deposition statements concerning a possible quick resale do not eliminate the question of fact as to whether Hocking expected the efforts of others to carry the investment until he could sell it.

Judge Norris, joined by Judges Wiggins, Brunetti, O'Scannlain and Trott, dissented in a separate opinion, stating that if Dubois' sale of the Liebermans' condominium is swept under the majority's "presented as part of the same transaction or scheme" standard, any realtor would be well-advised to steer clear of the subject of rental pools in the course of selling condominiums. Such a result is counterproductive.

Judge Wiggins, joined by Judge Trott, also dissented in a separate opinion, stating that holding a real estate broker liable for the sale of an individual condominium apartment strays too far from the dominating purpose of the Securities Act of 1933 and the Securities Exchange Act of 1934.

COUNSEL

Patrick C. Clary, Las Vegas, Nevada, for the plaintiff-appellant.

Samuel H. Gruenbaum, Los Angeles, California, for the defendants-appellees.

OPINION

GOODWIN, Chief Judge:

Gerald M. Hocking, a disappointed purchaser of a unit in a condominium complex in Hawaii sued the brokers who sold the unit, claiming violations of the antifraud provisions of the Securities Exchange Act of 1934, 15 U.S.C. § 78j (1982), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1988). He appeals a summary judgment in favor of the brokers.

After a three-judge panel's decision had reversed the summary judgment,[1] the court granted rehearing en banc and the case was reargued on supplemental briefs focused upon the question whether the transaction at the heart of this case involved a "security" within the meaning of the federal security laws.

The district court noted that "this action lies close to the edge of those transactions which have been found to be regulated by the Securities Act as investment contracts," but concluded that Hocking had not raised a triable issue of material fact as to whether DuBois had offered him a "security."

As best we can ascertain from the present record,[2] and reading it in the light most favorable to Hocking, the facts are as follows:[3]

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[1]839 F.2d 560 (9th Cir. 1988)(opinion withdrawn by order of December 7, 1988).

[2]In support of their motion for summary judgment, defendants submitted excerpts from Hocking's deposition. The remainder of the deposition is not in the record. Hocking challenges the admissibility of sections of his deposition. As he failed to object before the district court, he has waived this argument and may not raise it on appeal.

[3]In stating the "facts" we rely on Hocking's deposition testimony, his affidavit, and the relevant agreements, all read in light of his complaint. We recognize that, with regard to issues raised by defendants in their joint

Hocking was a resident of Las Vegas, Nevada. Following a visit to Hawaii, Hocking became interested in purchasing a condominium there as an investment. Deposition at 12, 52. Dubois was a real estate agent licensed in Hawaii, employed by defendant Vitousek & Dick Realtors, Inc. Dubois met Hocking through her husband, one of Hocking's co-workers. Deposition at 12.

Dubois agreed to search for a condominium for Hocking, and in the spring of 1979 proposed that Hocking purchase a condominium in the resort complex at 2121 Ala Wai, Honolulu, which had been listed with Vitousek & Dick. Deposition at 7-8. The resort complex was developed by Aetna Life Insurance Company, and was still under construction at that time. Deposition at 33. Hocking had told Dubois that he wanted to buy a condominium directly from the developer, to be a "first person buyer." Deposition at 8. In fact, the condominium unit sold to Hocking was owned by Tovik and Yaacov Liberman, who had purchased from the developer. Agreement of Sale, ER at 10, 19. Hocking did not independently inquire into who was developing the complex at 2121 Ala Wai, but relied on Dubois' assurances that he would be

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motion for summary judgment, Hocking "may not rest upon the mere allegations" of his complaint. Fed.R.Civ.P. Rule 56(e). With regard to those "portions of 'the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any' which [defendants] believe[] demonstrate the absence of a genuine issue of material fact." *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986), we do not rely on the complaint, but provide record citations to the facts Hocking relies upon. In describing the background of the case, however, we include facts that are, at present, mere allegations of the complaint, not challenged by defendants in their motion for summary judgment. We do not mean to suggest that, should defendants challenge — by motion for summary judgment, for a directed verdict, or for judgment notwithstanding the verdict — whether Hocking has raised a triable issue of fact on some other issue, for instance, whether he has produced any evidence that he actually lost his investment, our statement that he lost the investment should be construed as creating a triable issue on that question.

purchasing directly from the developer. (At this stage of the record the question of buying directly from the developer or in the "secondary" market is only of evidentiary value in shedding light on the terms of sale). Hocking had no contact with Aetna, and he knew of no connection between defendants and the builders of the condominium complex. Deposition at 101-102.

Dubois told Hocking, according to his deposition, that "the investment would be handled [for him] by a local company, or her company or someone that she would help [him] get in touch with." Deposition at 8. She informed Hocking that a rental pool arrangement (RPA) would be available to Hocking if he were to purchase the condominium. She also told him that the condominiums were renting for an average of $100 a day, from which he calculated the monthly income would be $2,000 to $3,000 per month. Affidavit at 2. He relied on the expected rental income to cover his monthly payments and provide additional income. *Id.* While Dubois expressed no requirement that Hocking participate in the rental pool arrangement, Hocking testified that but for the availability of the rental pool arrangement he would not have purchased the condominium. Deposition at 62-63.

Hocking entered into an agreement to purchase the condominium from the Libermans. He signed the agreement on June 23, 1979 in Nevada, and Tovik Liberman signed on July 2, 1979 in Hawaii. Agreement of Sale, ER at 19. Hocking also entered into several agreements with Hotel Corporation of the Pacific (HCP) concerning rental of the condominium.

On June 29, 1979 he signed a rental management agreement (RMA) appointing HCP exclusive agent to manage his condominium. ER at 24. He also entered into an Individual Agency Rental Agreement for Pooled Operation, the RPA, executed on July 5, 1979, to become effective on December

20, 1979. Supplemental ER at 240. This agreement placed Hocking's condominium in HCP's rental pool.[4]

Finally, on July 21, 1979, he signed an addendum to the RPA, which HCP executed on July 31, 1979. Supplemental ER at 243. Among other things, this addendum postponed the effective date of the RPA until the earlier of December 31, 1982 or that time when the developer had sold all the units in the development.

Hocking testified in his affidavit that Dubois presented these agreements to him and assured him they were mere standard forms, and further, that he neither read nor fully understood the agreements he signed. Affidavit at 4.

The rental management agreement gave Hocking the right to terminate the RMA upon 30-days written notice, with termination effective at the end of any current lease. The RPA's termination provisions are more complicated. During the initial year of pooled operation Hocking had the right to terminate at any time upon 15-days notice. In subsequent years he could terminate the RPA once annually upon 90-days notice. HCP reserved the right to terminate should the number of units participating in the rental pool fall below 40 percent of the total number of units in the complex. The condominium owners could collectively terminate the RPA upon an election to do so by 75% of those participating in the RPA. The RPA was to terminate on December 31, 1984. Finally, HCP was given the option to renew the RPA for two additional five-year terms.

Hocking alleges that his investment was entirely passive.

[4]Under the RPA, HCP is responsible for renting as many of the participating units in the complex as possible; the rental income from the units is pooled, and after each owner is assessed a pro rata share of HCP's costs, each owner receives a pro rata share of the rental income, whether or not his individual unit has actually been rented.

and that he relied on Dubois to select, manage, and protect his investment. Third Amended Complaint at 2-3. He relinquished control of his investment at the time he purchased it and had access to his unit for only two weeks each year. Affidavit at 3. He knew that approximately fifty other condominium owners participated in the rental pooling arrangement. *Id.* When he visited the building in Hawaii, he observed that it was operated like a hotel, and he received copies of brochures and advertisements which HCP distributed on the mainland. *Id.*

Hocking purchased the condominium for $115,000, with a downpayment of $24,000 and installment payments on the remaining portion of the purchase price through June 1982, at which time all unpaid amounts were to become due. Hocking's complaint states that he "cancelled" his investment when this balloon payment came due. Third Amended Complaint at 4. The failure to make the payment apparently caused the forfeiture of his prior payments. He claims the loss of his investment was caused by the failure to receive the expected rental income, and by further misrepresentations of Dubois concerning appreciation in the value of the condominium and her efforts to resell the condominium in 1981 and 1982. Third Amended Complaint at 3-5; Affidavit at 2-3.

We are in general agreement with the three-judge panel's statement of our function in reviewing a summary judgment:

> We review the grant of summary judgment *de novo*. *SEC v. Belmont Reid & Co.*, 794 F.2d 1388, 1390 (9th Cir. 1986). Our task is identical to the trial court's: while viewing the evidence in the light most favorable to Hocking, we must determine whether the defendants have shown that there are no disputed issues of material fact and that they are entitled to judgment as a matter of law. *Alaska v. United States*, 754 F.2d 851, 853 (9th Cir.), *cert. denied*, 474 U.S. 968, 106 S.Ct. 333, 88 L.Ed.2d 317 (1985). We

> also review *de novo* the district court's determination whether a transaction is a security. *Belmont Reid & Co.*, 794 F.2d at 1390.

839 F.2d at 563.

The Supreme Court has provided further guidance on the appropriateness of summary judgment in *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986). *Celotex* tells us that on an issue where the plaintiff has the burden of proof, as Hocking does here, the defendant may move for summary judgment by simply pointing out the absence of facts to support the plaintiff's claim, "identifying those portions of 'the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any' which it believes demonstrate the absence of a genuine issue of material fact." *Celotex*, 477 U.S. at 323. "[T]he plain language of Rule 56(c) mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." *Id.* at 322.

Defendants' joint motion for summary judgment identified portions of the pleadings and other materials which they believed demonstrated the absence of a genuine issue of material fact. Defendants claimed they were entitled to summary judgment because: (1) Hocking had no contact with the developer, Aetna; (2) Hocking alleged no connection between defendants and Aetna; (3) Hocking did not depend on HCP to increase the value of his condominium; (4) Hocking was not required to enter into the RPA as a condition of purchasing the condominium; (5) defendants made no representations regarding how much income the condominium would produce; and (6) Hocking intended to sell the condominium within a short time after purchase.

Defendants claimed that, based on these facts, Hocking had failed to raise a triable issue of fact as to whether he had

purchased a security. First, Hocking's testimony established that he did not depend on HCP to increase the value of his property, making it clear that he was not dependent upon the managerial efforts of others, and therefore failed to meet the *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), test as outlined in *SEC v. Glenn W. Turner Enters. Inc.*, 474 F.2d 476 (9th Cir. 1973).

Second, Hocking did not purchase the condominium from Aetna, he was not required to enter into the RPA as part of the purchase, the previous owner had not entered into an RPA, and the rental agreement he entered into was not part of the sale of the Liberman's condominium. Therefore, Hocking had not raised a triable issue as to whether there was an 'offering' as required under Securities Act Release No. 33-5347.[5]

Third, Hocking had proposed to Dubois that he enter into a like-kind exchange for the condominium. This proposal demonstrated that Hocking was well-informed, sophisticated, and placed little reliance on Dubois.

Hocking responded with an affidavit. He testified, among other things, that: (1) while Dubois did not represent how much rent he would receive each month, she did tell him what he could expect on a daily basis; (2) he did depend on income from the pooling agreement to cover monthly rent payments, and would not have purchased the condominium without the collateral rental agreements; (3) failure to receive the rental income led to loss of the investment; (4) he did rely on the

[5]In their joint motion for summary judgment, defendants did not challenge the factual allegation of Hocking's complaint that Dubois informed Hocking a rental pool would be available to him, and "Dubois offered to Hocking . . . a rental arrangement or rental pool arrangement . . . ." Complaint at 2. As counsel for Vitousek & Dick stated in oral argument before the three-judge panel, "it is undisputed that the broker did, at his request, go out and find him someone to enter into a rental agreement with him. There isn't any question about that."

managerial efforts of HCP, relinquishing control over the condominium to HCP and giving up access for all but two weeks a year; (5) he was not a sophisticated investor, but lacked education, training, or experience; (6) the like-kind exchange was not his idea, but something proposed to him by a local real estate agent in Las Vegas; (7) Dubois repeatedly told him that the value of the condominium was increasing, and that he should not sell it.

Hocking did not deny his lack of contact with Aetna, or his lack of knowledge of any connection between defendants and Aetna.

As the non-moving party, Hocking had no occasion to raise issues of fact regarding any links between Dubois and HCP, since defendants had not claimed that the lack of such links entitled them to summary judgment.

[1] In order for Hocking to make a claim under the securities laws, he must show that Dubois' alleged misrepresentations were made in connection with the purchase or sale of a security. Both section 2 of the Securities Act of 1933, 15 U.S.C. § 77b(1)(1982), and section 3 of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10)(1982), define the term "security" to include any "investment contract."

The term "investment contract" has been interpreted to reach "[n]ovel, uncommon, or irregular devices, whatever they appear to be . . ." *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943). "It embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *Howey Co.*, 328 U.S. at 299 (1946).

[2] In *Howey*, the Supreme Court found that the combined sale of land and a land service contract, under which the purchaser relinquished all control over the land for a 10-year

period, was an investment contract. The Court there put forward the classic definition of an investment contract:

> [A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.

Id. at 298-99. *Howey* rejected the suggestion "that an investment contract is necessarily missing . . . where the tangible interest which is sold has intrinsic value independent of the success of the enterprise as a whole." *Id.* at 301.

Subsequent cases have merely refined the three prongs of the *Howey* test. While the first prong, an investment of money, has proved relatively simple, the other two have evolved with time. As discussed below, the second prong's requirement of a "common enterprise" has been construed by this Circuit as demanding either an enterprise common to the investor and the seller, promoter or some third party (vertical commonality) or an enterprise common to a group of investors (horizontal commonality).

While *Howey*'s third prong demanded an expectation of profits "solely from the efforts of the promoter or a third party," *Id.*, 328 U.S. at 299, we have dropped the term "solely" and instead require that "the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." *Glenn W. Turner Enters.*, 474 F.2d at 482.

[3] We must therefore determine whether Hocking's purchase of a condominium and rental pool was (1) an invest-

ment of money, (2) in a common enterprise, (3) with an expectation of profits produced by the efforts of others.

In *Howey*, as here, the investors purchased real estate and at the same time relinquished much of the right to use or enter the property. 328 U.S. at 296. In *Howey*, as here, the investors were not obligated to purchase the service contracts, and in fact some decided to purchase the land without a service contract. *Id.* at 295. In *Howey*, as here, the investors were generally non-residents who lacked the skill, knowledge and equipment necessary to manage the investment. *Id.* at 296.

There is no doubt that, had Hocking purchased the condominium and the rental pool directly from the developer and an affiliated rental pool operator, and had the rental pool been for a long term without any provision for early termination, Hocking would have purchased a security. If that were the case, we would merely substitute Hocking's Hawaiian condominium for *Howey*'s Floridian citrus grove.

Hocking, however, did not purchase the condominium in the initial offering from the developer. He purchased in the secondary market from the Libermans. Further, Hocking entered into the rental pool agreement with HCP, and has, defendants argue, failed to demonstrate any link between HCP and the developer. Finally, unlike the investors in *Howey*, Hocking could legally terminate the RPA according to its terms and regain control over the condominium. We must determine therefore whether these differences from *Howey* make Hocking's alleged transaction into an ordinary real estate purchase or whether it nevertheless could prove to be the purchase of a security.

SECURITIES AND EXCHANGE COMMISSION RELEASE

The Securities and Exchange Commission has long recognized the securities laws' potential applicability to sales of

condominiums for investment. In 1973 the SEC issued a release in order to "alert persons engaged in the business of building and selling condominiums . . . to their responsibilities under the Securities Act and to provide guidelines for a determination of when an offering of condominiums or other units may be viewed as an offering of securities." Offers and Sales of Condominiums or Units in a Real Estate Development, Securities Act Release No. 33-5347, 1 Fed. Sec. L. Rep. (CCH) ¶ 1049 (Jan. 4, 1973)(listed at 17 C.F.R. § 231.5347(1988)).

Release 5347 puts developers and promoters on notice of three situations which the SEC views as involving the offering of a security.[6] The three-judge panel found the second of these situations present: Hocking's transaction included "[t]he offering of participation in a rental pool arrangement." While the district court had held that the optional nature of the rental pool took it out of the SEC guidelines, the panel rightly pointed out that neither Release 5347 nor *Howey* are limited to mandatory collateral arrangements. 839 F.2d at 565. The release speaks of an "offering" of a rental pool arrangement, not a requirement that the purchaser enter an RPA. As noted

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[6]The release describes three situations which would involve the offering of a security:

> 1. The condominiums, with any rental arrangement or other similar service, are offered and sold with emphasis on the economic benefits to the purchaser to be derived from the managerial efforts of the promoter, or a third party designated or arranged for by the promoter, from rental of the units.
>
> 2. The offering of participation in a rental pool arrangement; and
>
> 3. The offering of a rental or similar arrangement whereby the purchaser must hold his unit available for rental for any part of the year, must use an exclusive rental agent or is otherwise materially restricted in his occupancy or rental of his unit.

38 Fed. Reg. at 1735, 1736 (1973).

above, in *Howey* the purchasers were not obligated to enter into service contracts.

On rehearing en banc, the Securities and Exchange Commission has filed an *amicus* brief with the court, putting forward a different argument why Release 5347 is not controlling. The SEC points out that Release 5347 applies to "persons engaged in the business of building and selling condominiums . . .," 1 Fed. Sec. L. Rep. (CCH) ¶ 1049, at 2070, and not to brokers in the secondary market. Not only does the SEC claim the release applies only to developers, it claims that, although not readily apparent from the language of the release, and although perhaps inconsistent with the SEC Division of Corporate Finance's refusal to take a no-action position in *Embarcadero*, [1976-77] Fed. Sec. L. Rep. (CCH) ¶ 80,956 (Dec. 3, 1976), the release only applies to developers who have an affiliation or selling arrangement with a rental pool operator.

Given the SEC's position, we do not rely on Release 5347 in determining whether Hocking was offered a security. We instead examine the alleged transaction entirely in terms of the *Howey* test.

THE PACKAGE OFFERED TO HOCKING

[4] Before applying the *Howey* test to the facts of this case, we must determine what exactly Dubois offered to Hocking. Most of the cases finding a real estate transaction to involve a security have been direct offerings from a developer that include collateral agreements. This fact has led defendants to attempt to distinguish Hocking's purchase based on the lack of supposedly necessary links between the developer, the Libermans, HCP and Dubois. Hocking, however, has not claimed that the developer, the Libermans, or HCP sold him a security. He claims that by promoting the Libermans' condominium "with an emphasis on the economic benefits to be derived from the managerial efforts of third parties desig-

nated or arranged for by Dubois," and by including with the condominium an offer for a rental arrangement or rental pool arrangement, *Dubois* offered him a security.

There is no question that Dubois offered Hocking the condominium. The Libermans had listed their unit with Vitousek & Dick, and Dubois acted as the Liberman's real estate agent in selling the condominium to Hocking. Defendants argue, however, that Dubois could not "offer" the RPA or other rental agreements to Hocking.

Nothing in the record indicates, and Hocking has not argued, that Dubois could legally bind HCP to enter into the RPA or other agreements with Hocking. There is no evidence that the Libermans transferred to Hocking a legally enforceable option to join the RPA, or that Dubois had legal authority to act on behalf of HCP. Dubois could not "offer" the RPA in the sense of common law contract offer and acceptance.

[5] The inability of Dubois to make a binding contractual "offer" of the RPA to Hocking, however, does not mean that the RPA cannot be considered part of the package she offered him for purposes of determining whether that package was a security under *Howey*. In attempting to determine whether a scheme involves a security, the inquiry is not limited to the contract or other written instrument. "Characterization of the inducement cannot be accomplished without a thorough examination of the representations made by the defendants as the basis of the sale. Promotional materials, merchandising approaches, oral assurances and contractual agreements were considered in testing the nature of the product in virtually every relevant investment contract case." *Aldrich v. McCulloch Properties, Inc.*, 627 F.2d 1036, 1039-40 (10th Cir. 1980) (citations omitted)(reversing dismissal of complaint claiming that land sale with collateral representations involved a security); *see also Jenne v. Amrep Corp.*, [1978] Fed. Sec. L. Rep. (CCH) ¶ 96,343 (D.N.J. 1978). As the Supreme Court has repeatedly said:

> [I]n searching for the meaning and scope of the word 'security' in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality. *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967).

United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 848 (1975). In defining the term investment contract, *Howey* itself uses the terms "contract, transaction or scheme," 328 U.S. at 298-99, leaving open the possibility that the security not be formed of one neat, tidy certificate, but a general "scheme" of profit seeking activities. Such a "scheme" cannot be fully assessed by examining only those items a broker was legally authorized to offer an investor.

[6] Similarly, it is worth noting that the term "offer" has a different and far broader meaning in securities law than in contract law. *See, e.g., Diskin v. Lomasney & Co.*, 452 F.2d 871, 875 (2d Cir. 1971)(Friendly, J.); *SEC v. Commercial Inv. & Dev. Co. of Florida*, 373 F. Supp. 1153, 1164 (S.D. Fla. 1974)(finding a newsletter stressing the importance of shareholders' soliciting others was "offer to sell"). It is enough if the items were presented to Hocking as part of the same transaction or scheme, and that he purchased them as such.

Hocking states in his deposition and affidavit that Dubois assured him rental of his investment would be taken care of for him, Deposition at 8, that it would be handled by "the company" for him, Deposition at 27, that she informed him of the average daily rental, Affidavit at 2, that she presented the rental agreements to him for his signature, Affidavit at 4, and that without the rental agreements, he would not have entered into the transaction. Deposition at 62-63. It is undisputed that Dubois did go out and find someone to enter into a rental agreement with Hocking. These facts support the allegations of Hocking's complaint that:

> [a]s part of the said transaction, DuBois offered to Hocking and included [with the condominium] a

> rental arrangement or rental pool arrangement for the said condominium with emphasis on the economic benefits to Hocking to be derived from the managerial efforts of third parties designated or arranged for by DuBois from rental of said condominium. . . . Hocking's said investment was entirely passive, and he relied solely upon DuBois to select, manage, and protect his investment.

Complaint at 2.

We also cannot ignore the fact that HCP did accept the RPA and other agreements Hocking signed, and that these agreements were entered into immediately following the purchase of the condominium.

[7] Even if Dubois could not legally bind HCP to enter into the rental arrangements with Hocking, we think it "not inappropriate that [Dubois'] offerings be judged as being what they were represented to be." *Joiner Leasing Corp.*, 320 U.S. at 353 (1943). Hocking has put forward numerous facts concerning whether the condominium sale and rental agreements were presented to him as parts of one transaction. These facts distinguish this case from the everyday situation where a real estate agent or broker merely provides information to the purchaser regarding the availability of a rental pool or shared amenities such as a swimming pool or tennis courts. They also distinguish this case from the situation where, after a purchase and separate from any inducement to purchase, a real estate agent or broker arranges for a rental pool. Taken together these facts are sufficient to raise an issue of material fact for the trier to decide whether the RPA and other agreements were part of one scheme or transaction Dubois offered Hocking.[7]

(Text continued on page 11655)

[7] In its amicus brief, the SEC argues that in the absence of any affiliation or selling arrangement between the sellers of the condominium (or the real estate agent) and the operator of the rental pool, the sale of a condominium

is not a transaction that involves an investment contract. The SEC cites as authority directly supporting this proposition *Blackwell v. Bentsen*, 203 F.2d 690, 693 (5th Cir.), *cert. dismissed*, 347 U.S. 925 (1953). *Blackwell*, a case differing from *Howey* only in "minor and non-determinative" aspects, merely restates the test we apply today, finding an investment contract where the sales of citrus groves and the offering of management services, "although separate in form," "form constituent parts of what is essentially one transaction. . . ." 203 F.2d at 692-93. Thus, while Judge Norris criticizes our "presented as part of the same transaction" test, this test is exactly that stated in *Blackwell*. We have yet to see any case authority supporting the position taken by the SEC and adopted in Judge Norris' dissent.

We agree with *Blackwell* that whether the transaction can be considered an investment contract depends upon whether the sale and the offering of management services form parts of what is "essentially one transaction." We do not agree that, although Hocking dealt with Dubois and only Dubois, an affiliation between Dubois and HCP, or the Libermans and HCP, should be required in order to determine that Dubois offered an investment contract in what was "essentially one transaction." In fact, any hypothetical arrangement between Dubois and HCP, such as Dubois receiving a commission for each member of the rental pool she signed up, would seem nearly irrelevant to the question of whether the condominium and RPA were presented as "essentially one transaction." Although the existence of such an arrangement would indirectly support Hocking's argument that Dubois presented the RPA to him, it would have no bearing on whether or not she presented the condominium and RPA as part of the same transaction. Dubois might enter an arrangement with HCP, yet only raise the issue of rental services months after a condominium purchase had been completed. In such a case, the economic benefits to be derived from the managerial efforts of third parties would not have been emphasized in the underlying sale.

Further, we note that defendants did not specifically argue below that a lack of affiliation between Dubois and HCP entitled them to summary judgment. They argued that a lack of any Aetna-HCP or Aetna-Liberman link entitled them to summary judgment. They did not argue the lack of any HCP-Dubois link, or even the lack of any HCP-Liberman link (with Dubois seen as the Liberman's agent). Defendants did argue that the rental agreement "was not offered as part of the sale," ER at 58, but even this argument was put forward as a reason why Hocking did not come within Release 5347, not in reference to the *Howey* test, and this argument was not based

THE *HOWEY* TEST

A. Investment of Money

Defendants attempt to pull apart the package into two separate transactions. They argue that even if Hocking did invest money in the condominium, he did not invest money *in the RPA*, and it is the RPA which provides the elements necessary to satisfy the *Howey* test's other requirements. Therefore, they claim, Hocking did not satisfy this first requirement.

[8] Admittedly, there would be an argument as to whether the "investment of money" requirement had been met if someone who already owned a condominium decided to place the condominium into a rental arrangement, independent of the decision to purchase the condominium. If, however, the condominium and rental agreements were offered as

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on the lack of an HCP-Dubois link. Of course, in his memorandum in opposition, Hocking did not attempt to show any affiliation between HCP and Dubois. If the lack of affiliation between HCP and Dubois were pivotal, as the SEC claims, Hocking would at least deserve the chance to raise facts which demonstrate such a link.

Lastly, Judge Norris cites *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 858 n.25 (1975), for the proposition that we should afford the views of the SEC "considerable weight." Ironically, the cited footnote in *Forman* notes that the SEC's position (that *Forman* presented an investment contract) flatly contradicted the SEC's views in then-recent Release 5347, the very release at issue in this case. As the Court pointed out, "[s]everal commentators have noted the inconsistency between the SEC's position in the above release and the decision by the Courts of Appeals in this case, which the SEC now supports." *Id.* (citations omitted). The SEC apparently reversed its position on interpreting this very release in *Forman*, and argued that the securities laws applied even in that extreme case.

Because of the SEC's inconsistent interpretations of Release 5347, and the lack of any case authority supporting its current position, we "accord no special weight to its views. See *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418, 426 (1972); *Blue Chip Stamps v. Manor Drug Stores*, [421 U.S.] at 746–47, n.10." *Forman*, 421 U.S. at 859, n.25.

a package, there can be no serious argument that Hocking did not invest money in the package. Since Hocking has created an issue of fact over whether the condominium and RPA were sold as a package, he has met this first requirement of *Howey* for purposes of summary judgment.

B. Common Enterprise

We agree with Judge Reinhardt's discussion for the panel of the Ninth Circuit law on *Howey*'s common enterprise requirement. 839 F.2d at 566-67. The Ninth Circuit accepts either traditional horizontal commonality or, when no pooling among investors is present, a strict version of vertical commonality.

[9] The simple purchase of real estate lacks any horizontal commonality, as no pooling of interests or profits is involved. The purchase of real estate combined with an RPA, however, does evidence horizontal commonality. The participants pool their assets; they give up any claim to profits or losses attributable to their particular investments in return for a pro rata share of the profits of the enterprise; and they make their collective fortunes dependent on the success of a single common enterprise. Because in this case Hocking has raised facts supporting horizontal commonality, we need not consider vertical commonality.

[10] Of course, whether Hocking can prove horizontal commonality at trial will depend on whether he can show that Dubois offered a package which included the RPA. As discussed above, Hocking has raised a genuine issue of fact as to that question.

C. Expectation of Profits Produced by the Efforts of Others

[11] This third prong of *Howey* forms the greatest hurdle for Hocking, assuming he can prove at trial that the condominium and rental agreements were part of one package. He must

show an expectation of profits produced by the efforts of others, that the efforts of others are "those essential managerial efforts which affect the failure or success of the enterprise." *Glenn W. Turner Enters.*, 474 F.2d at 482.

The crux of defendants' argument on this point is that the rental agreements allowed Hocking to maintain a high degree of control over his condominium, thus making any managerial efforts of Dubois or HCP non-essential to the success of Hocking's investment.

Hocking was not required to enter into any of the rental agreements as a prerequisite of purchasing the condominium. He elected to delegate control of the condominium to HCP. Further, the rental agreements gave Hocking various termination rights described above, allowing him to regain control over the use and management of his investment.

Defendants point out it was the purchaser's election to delegate control and ability to regain control that led to the conclusion that the third requirement of *Howey* had not been satisfied in *Fargo Partners v. Dain Corp.*, 540 F.2d 912, 915 (8th Cir. 1976). *See also Schultz v. Dain Corp.*, 568 F.2d 612 (8th Cir. 1978). Both *Fargo Partners* and *Schultz* involved purchasers of entire apartment buildings. The *Schultz* court limited the reach of its holding, noting that "this is not a case where a small investor must rely on the seller's efforts because he lacks business knowledge, finances or control over the operations. Schultz had considerable business experience . . . ." 568 F.2d at 616. The absence of any legal requirement to delegate control in *Fargo Partners* and *Schultz* amounted at the same time to the absence of any practical need to delegate control. As an inexperienced, non-resident, individual investor Hocking is different from Schultz.

Other cases show that the question of an investor's control over his investment is decided in terms of practical as well as legal ability to control. As defendants acknowledge, where the

investor maintains legal control over his investment (or the ability to regain control), in order to claim the investment is a security he must show practical dependence, an inability to exercise meaningful powers of control or to find others to manage his investment. *See Gordon v. Terry*, 684 F.2d 736, 742 (11th Cir. 1982); *Williamson v. Tucker*, 645 F.2d 404, 424-25 (5th Cir. 1981).

Williamson, the leading case on the control issue, states that where the investor is a general partner or joint venturer, he must establish that:

> (1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; or (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.

645 F.2d at 424. Of course, under different facts or legal arrangements other factors might give rise to such a dependence on the promoter or manager that exercise of control would be effectively precluded. *Id.* at 424 n. 15.

[12] We have previously adopted *Williamson*'s approach. *Deutsch Energy Co. v. Mazur*, 813 F.2d 1567, 1570 (9th Cir. 1987)(finding purchasers of oil well sites for $1.5 million were not "inexperienced and unknowledgeable members of the general public" and therefore were not incapable of exercising management powers over the investment); *Matek v. Murat*, 862 F.2d 720 (9th Cir. 1988)(applying *Williamson* test and holding no security alleged, as partnership agreement

"provided the plaintiffs with sufficient power to protect their investments," and they "made no showing and are unable to show they were prevented from exercising their powers under the agreement"). *Williamson* simply requires that we examine the economic reality of the investor's relation with the manager or promoter. *See McConnell v. Frank Howard Allen & Co.*, 574 F. Supp. 781 (N.D.Cal. 1983)(applying the *Williamson* test to deny summary judgment on securities claims of general partners in real estate partnership). Therefore, in the absence of any legal obligation to delegate control of his investment, Hocking must establish that his exercise of control was precluded for all practical purposes.

The record presents a material question of fact: was Hocking dependent on Dubois or HCP, and unable to exercise control over his investment? Hocking claims to be an unsophisticated, inexperienced investor, lacking any special training or education. He resides thousands of miles away from the location of the investment. He is not in the business of managing condominiums or other real estate. He has raised a genuine issue of fact whether he requested and received an offer of management services.

Further, Hocking observed that the condominium complex was "operated like a hotel from the lobby," and that HCP distributed brochures and advertisements on the mainland. Affidavit at 3. Numerous other condominium owners participated in the RPA, *id.*, and HCP reserved the right to terminate the RPA if the number of participating units fell below 40 percent of the units in the complex. Supplemental ER at 240. In the RPA agreement, the participating units are referred to as the "Resort." *Id.*

Hocking's affidavit and deposition raise a genuine issue of fact whether he *intended* his investment to be entirely passive, and whether, as alleged, he "relied solely on Dubois to select, manage, and protect" his investment. Complaint at 2-

3. This is, however, a different inquiry than whether he lacked the *ability* to manage his investment.

Hocking has not met the first factor suggested in *Williamson*. He has not raised facts showing that his arrangement with Dubois and HCP leaves him so little power as to place him in a position analogous to a limited partner. He certainly exercised more power, at least over his individual unit, than would a limited partner investing in the construction of a similar resort.

[13] Hocking has at least raised questions of fact material to *Williamson*'s second and third suggested factors. With regard to the second factor, he claims to be an unsophisticated and inexperienced investor; he is an individual making a "passive" investment from thousands of miles away. This raises the question whether he is incapable of intelligently exercising his legal powers to manage his condominium.

The third factor suggested in *Williamson* provides the closest fit to an investment in a resort condominium involving an RPA. Hocking's investment is a unit in a resort condominium, allegedly operated as a hotel, with many investors pooling their units together. In order for Hocking to replace HCP, he would have to gain the votes of 75 percent of participating investors. These facts alone create a real question whether Hocking was stuck with HCP as a rental manager. Had Hocking purchased a residential condominium for investment purposes, to be rented out to long-term tenants, then it would have been a relatively easy matter to switch rental agents. Managing a resort operated as a hotel, which solicits guests from the mainland and charges nightly rates for short-term visits, may be a much more difficult service to replace than that of a long-term leasing agent. The commercial viability of a one-room hotel does not strongly argue for separate management. The individual investor may have no choice but to place his condominium in the rental pool, if he is to receive significant rental income.

[14] Because Hocking's pleadings and affidavit raise issues of fact with regard to two factors considered in *Williamson*, we need not consider other factors or approaches that might demonstrate Hocking's practical inability to control his investment. Hocking has at least raised an issue of fact as to his ability to manage the investment, and as to the uniqueness of HCP's RPA as a method of producing income from the condominium.

[15] Defendants also protest that Hocking's deposition statements prove his intent was to resell the condominium quickly for a profit, and that he therefore could not have depended on rental income from the RPA for his profits, or expected profits from the efforts of the rental pool operator. Even in this regard, Hocking indicated he merely planned to sell "when [Dubois] instructed [him] it was the best time to sell." Further, in his affidavit Hocking testifies that the rental arrangement was a necessary element of the transaction, that he had expected the rental income to cover his monthly payment, and that the failure to receive the rental income resulted in the loss of his investment. Placed in this light, Hocking's deposition statements concerning a possible quick resale do not eliminate the question of fact concerning the third prong of *Howey* — whether Hocking expected profits from the efforts of others to carry the investment until he could sell it. The deposition statements that Hocking intended to resell quickly merely provide the type of conflicting evidence that a trial is designed to resolve.

CONCLUSION

We agree with defendants and amici that the three-judge panel may have written too broadly its conclusion that so long as a rental pool 'option' exists, all secondary market sales necessarily involve a security. Such a per se rule would be ill-suited to the examination of the economic reality of each transaction required by *Howey*. In the context of isolated resales, each case requires an analysis of how the condomin-

ium was promoted to the investor, including any representations made to the investor, and the nature of the investment and the collateral agreements. The investor's intentions and expectations as communicated to the broker would be relevant in determining what investment package was actually offered.

If the *Howey* analysis is undertaken, the securities laws are found to apply, and the application of the securities laws places undue burdens on developers, real estate brokers, or condominium owners, changes in the law should be sought from Congress or the Securities and Exchange Commission. *Howey*, on this record, requires this case to proceed beyond summary judgment.

REVERSED AND REMANDED.[8]

NORRIS, Circuit Judge, joined by Judges Wiggins, Brunetti, O'Scannlain and Trott, dissenting:

This case involves the resale of a condominium apartment in a resort complex in Hawaii. The developer of the complex had offered the original condominium purchasers the opportunity to participate in a rental pool arrangement (RPA) run by Hotel Corporation of the Pacific (HCP). In an RPA, an agent is responsible for renting and managing all apartments that participate in the pool, and each owner receives a pro

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[8]Appellees allege Hocking's en banc brief misstates the facts so egregiously that sanctions are required. Although Hocking's statement includes fewer citations to the record than Fed. R. App. P. 28(a)(3) and Ninth Cir. R. 28-2.8 require, and is, in some respects incomplete, it is sufficiently "well grounded in fact" that Rule 11 sanctions are not warranted. *See Unioil, Inc. v. E.F. Hutton & Co., Inc.*, 809 F.2d 548, 556-59 (9th Cir. 1986).

Appellees also seek fees under § 11(e) of the Securities Act of 1933, 15 U.S.C. § 77k(e). Since appellees have not prevailed, fees are not warranted.

rata share of the rental income. It is not disputed that a sale of a condominium by a developer who also provides an RPA normally constitutes the sale of a security.

Here the resellers of the condominium, the Libermans, had elected not to participate in the RPA when they purchased their condominium from the developer. In reselling the condominium, the Libermans' real estate agent, Dubois, informed the prospective buyer, Hocking, that the RPA was available should he wish to participate as a condominium owner. After buying the Libermans' condominium, Hocking in fact became a participant in the RPA managed by HCP. Hocking has not alleged or proffered evidence that Dubois had any affiliation or selling arrangement with HCP, or that Hocking was led to believe that she did.

The sole question presented by this appeal is whether these facts give rise to a genuine issue for trial as to whether the sale of the Libermans' condominium to Hocking constituted the sale of a security that is regulated by the federal securities laws. My view that it does not is based largely on the reasoning of the SEC in its *amicus* brief.

I agree with the SEC that in the absence of probative evidence of some affiliation or selling arrangement between the Libermans (or their agent Dubois) and the manager of the rental pool, the condominium sale did not involve the sale of a security because Hocking's contract to participate in the rental pool was a separate transaction. *See* Brief of *Amicus Curiae* SEC, at 3. I fear that the breadth of the majority opinion and the paucity of any probative evidence that Dubois did anything more than inform Hocking of the availability and economics of the rental pool will spawn litigation under the federal securities laws whenever a similar buyer becomes disappointed with the economic return he realizes from his condominium and RPA. Hocking, as a disappointed investor in a condominium and an RPA, is indistinguishable from thousands of others. The fact that his investment did not live

up to his expectations does not, without more, mean that he can sue the real estate agent for violation of the federal securities laws. Judge Hug put it succinctly in his dissent from the original panel decision when he said that "a broker who simply arranges for the sale of the unit and notifies the buyer that he may be able to enroll in the developer's rental pool is not offering a security. This is a real estate transaction and is properly governed by real estate law." *Hocking v. Dubois*, 839 F.2d 560, 571 (9th Cir. 1988).

I

A

Although the sale of real estate ordinarily does not involve an "investment contract" for purposes of the federal securities laws,[9] courts have held that the sale of real estate will constitute the sale of a security when related management services are provided either by the real estate promoter or by someone having an affiliation or selling arrangement with the promoter. *See, e.g., SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) (promoter sells land with service contract for cultivation of oranges; promoter of land and manager of orange groves were under "direct common control" of one another); *Cameron v. Outdoor Resorts of America, Inc.*, 608 F.2d 187 (5th Cir. 1979)(promoter sells condominium campsites, and retains exclusive right to rent campsites in owner's absence and to share profits with owner); *Wooldridge Homes v. Bronze*

[9] Section 2(1) of the Securities Act, 15 U.S.C. § 77b(1), and section 3(a)(10) of the Securities Exchange Act, 15 U.S.C. § 78c(a)(1), both define "security" as including an "investment contract." The leading case on the meaning of "investment contract" is *Howey*, which defined the term as "a contract, transaction or scheme whereby a person (1) invests his money (2) in a common enterprise and (3) is led to expect profits solely from the efforts of the promoter or a third party." 328 U.S. at 298-99. *See also United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975)(definition of investment requires "a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others").

Tree, 558 F. Supp. 1085 (D. Colo. 1983)(promoter sells unimproved resort property and promises to build condominiums and arrange for management services for two years); *Hodges v. H & R Investments*, 668 F. Supp. 545 (N.D. Miss. 1987) (promoter of condominium guarantees buyer minimum rental income and promises to pay referral fee to buyer).

A requirement of an affiliation or selling arrangement between the promoter of property and the provider of management services stems from the nature of an investment contract. An investment contract requires both an investment of money and an expectation of profits from the efforts of others. *See Howey*, 328 U.S. at 298-99. An investment of money in the purchase of a condominium is not, in itself, a securities transaction; nor does it become one when the purchaser independently procures management services from others. As the SEC puts it, "[u]nless there is a link between the seller of the property (or his agent) and the provider of services, these are two separate transactions, and the property sale is not covered by the securities laws." Brief of *Amicus Curiae* SEC at 10-11.

The SEC's view that Dubois' sale of the Libermans' condominium did not involve the sale of a security is consistent with the position taken by the SEC in Release 5347. The Release notes that "[t]he offer of real estate as such, without any collateral arrangements with the seller or others, does not involve the offer of a security." 1 Fed. Sec. L. Rep. (CCH) ¶ 1049, at 2071. However, the release states, "[w]hen the real estate is offered in conjunction with certain services, a security, in the form of an investment contract, may be present." *Id.* One such service noted in the release is an RPA. *Id.* 2072. The release makes clear that the investment contract test is satisfied where the condominium sale is "coupled with" the RPA. *Id.* at 2070. Where the condominium seller (or his agent) and the RPA operator have no affiliation or selling arrangement, there is no such "coupling." The SEC informs

us that this has long been its position in its enforcement policy under the securities laws:

> The release does not apply to persons who resell their own individual units . . . and have no affiliation or selling arrangement with the pool operator.
>
> The Commission's staff has expressed that understanding of the release on numerous occasions. Subsequent to the issuance of the Commission's release, persons involved in developing real estate projects have frequently sought the informal advice of the Commission's Division of Corporation Finance as to whether the Division would recommend Commission enforcement action if the property were sold without complying with the registration provisions of the Securities Act. The Division has declined to take a "no-action" position where there is an affiliation or selling arrangement between the developer [i.e. seller] and the rental pool operator. Where, however, no such affiliation or selling arrangement is present, the Division has taken a no-action position.

Brief of *Amicus Curiae* SEC at 13-14.

In my view, the SEC's position is a sound and principled attempt at drawing the line between those sales of residential real estate that involve an investment contract and those that do not. The SEC's position sensibly limits the reach of the federal securities laws by excluding sales of individual condominium units where the seller (or his agent) has no connection with anyone who provides management services, while at the same time including cases in which the seller is affiliated with a provider of management services. As a hypothetical illustration, suppose the seller in this case had been the developer of the resort complex and had operated an RPA for condominium owners who wished to participate. Suppose further that Dubois had been a real estate agent who had an

arrangement with the developer to sell units on commission and that Dubois hyped the developer's RPA as part of her sales pitch. In this hypothetical, the commission agreement between Dubois and the developer could satisfy the SEC's proposed requirement of a link between the seller of the property (or his agent) and the provider of investment services. Note that this result would obtain whether or not Dubois had authority to offer participations in the developer's RPA to prospective buyers of the condominiums.[10]

In the actual case before us, however, there is no evidence that the Libermans or their agent Dubois had any connection whatsoever with HCP, the operator of the RPA. As the SEC puts it, "Since in this case there is no suggestion of any affiliation or selling arrangement between the sellers of the condominium (or the real estate agent) and the operator of the rental pool, the sale of the condominium was not a transaction that involved an investment contract." Brief of *Amicus Curiae* SEC at 11. On this important and technical issue involving the applicability of the securities laws to real estate transactions, I believe we should afford the views of the agency charged by Congress with the responsibility for administering those laws "great weight." *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 858 n.25 (1975).[11]

[10]In this respect I agree with the majority that "legal authority" to offer the security is not required for an offering to take place within the meaning of the securities laws. See Majority Opinion at 11650-51.

[11]The majority contends that *Forman* does not require us to defer to the SEC's views in this case, because the Court there held that deference is inappropriate when the SEC reverses its position without explanation. In this respect, however, *Forman* is clearly distinguishable from today's case. In *Forman*, the issue was whether the purchase of cooperative apartment units was an investment contract, where the purchasers were buying the units to live in and were not seeking to "receiv[e] profits from the efforts of others." 421 U.S. at 858. In its brief *amicus curiae*, the SEC argued that the sale was an investment contract. The Supreme Court noted, however, that the SEC's argument contradicted its position in Release 5347, which had said that the securities laws cover only those real estate transactions in

B

The majority fails to afford any deference to the views of the SEC. Indeed the majority does not even discuss the SEC's position that in the absence of a link between Dubois and HCP, we should not hold that Dubois offered Hocking a security in the form of a participation in HCP's rental pool. Instead, the majority simply adopts its own test as to what constitutes the offering of a security in the context of a condominium sale and a rental pool agreement: "It is enough if the [condominium and RPA participation] *were presented to Hocking as part of the same transaction or scheme*, and that he purchased them as such." Majority Opinion at 11652 (emphasis added). In my view, this test is much too imprecise to serve as a meaningful standard for determining when a realtor's discussion of an available RPA transforms a condominium sale into a sale of a security. For aught I can tell, under the majority's standard a sale of a condominium may be converted into a securities transaction anytime a real estate agent informs the buyer about an available RPA. The majority's

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which the real estate is "offered and sold with emphasis on the managerial efforts" of others. 421 U.S. at 858 n.25 (quoting Release 5347, 38 Fed. Reg. 1735, 1736 (Jan. 18, 1973). In the Court's view, the SEC's new position — which seemed to abandon the requirement of "profits from the efforts of others" — represented an "unexplained contradiction" of its previous position.

By contrast, the SEC's position in the current case is entirely consistent with Release 5347. The SEC is attempting to rein in the expansive interpretation of Release 5347 by insisting that it does not apply to brokers in the secondary condominium market who have no affiliation with persons selling investment services. The majority notes that the SEC's interpretation of Release 5347 is "not readily apparent from the language of the release." Majority opinion at 11650. Perhaps not, but nothing in the release ever remotely suggested that brokers lacking any connection with the seller of management services was subjeect to the securities laws. The SEC's position is entirely consistent with the Release and with common sense. Because the SEC is not contradicting itself as it was in *Forman*, I believe its views are entitled to deference.

test is so standardless that unwary realtors who do nothing more than advise prospective condominium purchasers about the availability and economics of an RPA will find themselves in federal court defending actions brought under the federal securities laws on the authority of the decision in this case.[12]

The majority protests that

> Hocking has put forward numerous facts concerning whether the condominium sale and rental agreements were presented to him as parts of one transaction. . . . [which] distinguish this case from the everyday situation where a real estate agent or broker merely provides information to the purchaser regarding the availability of a rental pool or shared amenities such as a swimming pool or tennis courts.

Majority Opinion at 11653. In my view, this gossamer distinction between "merely provid[ing] information" and "present[ing] as part of the same transaction" is no distinction at all. I can find nothing in either the majority's analysis or the "numerous facts" put forward by Hocking that indicates where the line is to be drawn, or what it is about the present case that places it on one side of the line rather than the other. As I read the opinion, the majority does not require any evidence of facts that would distinguish this case from the garden-variety transactions that the majority asserts its standard will not reach. Rather, the majority relies on the unexceptional facts that Dubois provided Hocking with information about the RPA and that she obtained the RPA forms for him. *See id.* at 11652-53. The majority also apparently relies on Hocking's assertion "that without the rental agreements, he would not have entered into the transaction."

[12]The National Association of Realtors is legitimately concerned about this peril to its industry. *See* Brief *Amicus Curiae* of the National Association of Realtors, at 5.

id., although I fail to see the relevance of *Hocking*'s subjective state of mind to the question whether *Dubois* offered a security.

In sum, while a jury could doubtless infer from the evidence cited by the majority that the condominium and RPA "were presented to Hocking as part of the same transaction," I can see no reason why a similar inference could not be drawn in *any* case in which a broker "merely provide[d] information to the purchaser regarding the availability of a rental pool," *id.* at 11653.[13] The majority asserts that the two situations are different, but fails to provide any principled basis for making the distinction. Because of this absence of a limiting principle, I fear that the majority's test will prove to be nothing but a recipe for indiscriminate use of the federal securities laws against real estate agents involved in the sale of condominiums.

I know of no precedent for the majority's "presented as part of the same transaction" test for determining when the purchase of a condominium and a participation in a rental pool may be coupled for purposes of the federal securities laws. In the real estate cases cited by the majority there was in fact a link between the seller of the real estate and the manager of related investment services,[14] just as the SEC urges there must be. As I noted above, had Dubois been affiliated with HCP and used HCP's rental pool as an inducement to persuade Hocking to buy the condominium, the securities laws might well have covered the transaction. *See supra* page 11668. But it is undisputed that Dubois had no such affiliation, and the majority offers absolutely no authority — and, indeed, no

[13]Dubois' assistance in obtaining the RPA forms for Hocking is surely too inconsequential to create a meaningful difference between this case and any other case in which a real estate agent merely provides information to a prospective purchaser.

[14]*See, e.g., Howey*, 328 U.S. at 296; *Aldrich v. McCulloch Properties, Inc.*, 627 F.2d 1036 (10th Cir. 1980).

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explanation — for its conclusion that a realtor is subject to the federal securities laws in the absence of an affiliation or selling arrangement with a seller of investment services. The cases cited by the majority for the proposition that the term "offer" has a broader meaning in securities law than in contract law are merely authority for the undisputed proposition that a realtor need not be "legally authorized" to offer an investment contract as part of a real estate transaction to convert it into a sale of a security.[15] They are not authority for the proposition that a condominium sale may be a security transaction in the absence of a link between the seller and the provider of investment services.

Nor is *Blackwell v. Bentsen*, 203 F.2d 690 (5th Cir.), *cert. dismissed*, 347 U.S. 925 (1953), authority for the majority's standard. *Blackwell* involved the purchase of citrus groves and harvesting services. Although the real estate and the management services were sold by different companies, the two companies were owned and operated by the same people. The Fifth Circuit held that, because the land and services were sold as "essentially one transaction," the entire sale was covered by the securities laws. The majority claims that *Blackwell*'s "essentially one transaction" language supports the majority's "presented as the same transaction" standard, but it obviously does nothing of the sort. In *Blackwell* there was a clear affiliation between the seller of real estate and the seller of management services, whereas in this case there was none. The majority overlooks this distinction as though it were a mere incidental fact, when it is critical.

[15] Moreover, in the cases cited by the majority, the offeror was affiliated with the seller of investment services. *See Diskin v. Lomasney & Co.*, 452 F.2d 871, 875 (2d Cir. 1971) (stock prospectus circulated by stockbroker); *SEC v. Commercial Inv. & Dev. Co. of Florida*, 373 F. Supp. 1153, 1164-65 (S.D. Fla. 1973) ("newsletter" issued by investment company).

II

This case is before us on an appeal from summary judgment in favor of Dubois. In order to defeat summary judgment, Hocking must produce evidence that would permit a jury to find, by a preponderance of the evidence, the facts necessary to sustain his claim that Dubois offered him a security. *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 252 ("The judge's inquiry . . . asks whether reasonable jurors could find by a preponderance of the evidence that the plaintiff is entitled to a verdict."). If the evidence in the record "is such that it 'would require a directed verdict' " against Hocking, then there is no issue of fact for trial and summary judgment is appropriate. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 250 (1987). In order to meet his burden of raising material issues of fact, Hocking must adduce evidence that is "significantly probative" of his claim. *First Nat'l Bank v. Cities Service*, 391 U.S. 253, 288 (1967); *ALW, Inc. v. United Airlines, Inc.*, 510 F.2d 52, 55 (9th Cir. 1975). The evidence must be more than a "mere scintilla." *British Airways Bd. v. Boeing Co.*, 585 F.2d 946, 952 (9th Cir. 1978).

In my view, the evidence before us, even when interpreted in the light most favorable to Hocking, proves no more than the following facts: In the course of selling Hocking the Libermans' condominium, Dubois advised Hocking about the availability and economics of HCP's rental pool arrangement, and discussed the investment potential of a combination of the appreciation on the condominium and the cash flow from the RPA. She assisted Hocking in preparing an application to HCP for a participating interest in the RPA, and offered to help him resell the condominium at some time in the future.

These facts, if true, fail to distinguish this transaction in any principled way from any other sale of a resort condominium that involves a discussion between the sales agent and the buyer about the availability and economics of an RPA. Surely

the federal securities laws were never intended to discourage realtors from performing their important function of providing prospective buyers with as much relevant information as possible to help them make informed judgments about the property they are considering. It was obviously important to Hocking to know about HCP's rental pool and its economic potential. It was natural for him to want the benefit of his realtor's knowledge and advice on the subject. Giving advice on the investment potential of a security cannot properly be equated with offering a security. Yet the majority's "presented as part of the same transaction or scheme" test is so broad and imprecise that it could readily be interpreted as encompassing virtually any condominium sale involving a discussion between the realtor and the buyer about an RPA.

The majority cites Hocking's deposition testimony that Dubois told him that "the investment would be handled by a local company, or her company or someone that she would help [him] get in touch with." Hocking deposition, Record on Appeal ("ROA") at 64, quoted in Majority Opinion at 11641. In my view, this snippet of testimony has no significant probative value. It is so equivocal that it's hard to tell what material fact, if any, the testimony tends to prove. Nor does the majority enlighten us as to the probative value of the testimony under its "presented as part of the same transaction or scheme" standard. In context, the testimony cannot possibly mean that Hocking was saying that he expected anyone other than HCP to be responsible for the management of the RPA.[16] The testimony indicates only that Dubois promised

[16]In his testimony, Hocking stated unequivocally that he understood that HCP was responsible for managing the RPA:

> I knew and relied upon the fact that approximately fifty other condominium owners participated in the pooling arrangement of which I was a part. The monthly statements which I received from *the company operating the pooling arrangement* indicated that I was receiving approximately 2% of the total rental income from the building each month. When I visited my condominium, I

that she would assist Hocking in the purchase and resale of the condominium, and that this assistance would include helping him apply to HCP for an RPA participation.[17] If Hocking intended to try to prove by this scintilla of evidence that Dubois or her employer Vitousek & Dick had an affiliation with HCP or its rental pool, he could easily have submitted a clarifying affidavit to that effect in opposition to Dubois' motion for summary judgment. On the record before us, however, I fail to see how this excerpt of his deposition testimony is probative of anything beyond a routine sale of a resort condominium.

> observed that the building in which it was located was operated like a hotel from the lobby, and I received copies of the brochures and advertisements which *the pooling company* distributed to the mainland. I relinquished control of the condominium *to the pooling company* right at the time I purchased it and only had access to it for not more than two weeks per year.

Hocking affidavit ¶ 6, ROA at 93.

[17]It is instructive to read Hocking's testimony immediately preceding the excerpt quoted by the majority:

> [Hocking:] That was my purpose in investing in Hawaii, to be a first-person buyer and, shortly after it topped off, to then turn it around and sell it.
>
> . . . .
>
> [Question:] You said as soon as it was topped off, you would turn around and sell it.
>
> What do you mean by that?
>
> [Hocking:] I was informed by my real estate agent, Miss Dubois, that the way to invest in Hawaii was to buy an investment in a condominium or something along that line before the building is finished and then, when the building is finished, the property will have appreciated.
>
> Shortly thereafter, it has appreciated to the greatest extent. *We would then turn around and sell it. There was no worry about coming up with more money because the investment would be handled by a local company or her company or someone that she would help me get in touch with.*

Hocking Deposition, ROA at 64 (emphasis added).

In sum, if Dubois' sale of the Libermans' condominium is swept under the majority's "presented as part of the same transaction or scheme" standard, then I think the standard is so all-encompassing that any realtor would be well-advised to steer clear of the subject of rental pools in the course of selling condominiums. Such a result, I believe, is counterproductive and fails to serve any of the purposes of the federal securities laws. I would affirm the summary judgment for the defendants.

WIGGINS, Circuit Judge, joined by Judge Trott, dissenting:

Stated precisely, the issue in this case is whether a real estate broker can be held liable under the federal securities laws for marketing a condominium apartment whose buyer is entitled, but not obligated, to join a rental pool offered and managed by a party not affiliated with the seller. The majority believes that if the real estate broker markets the condominium apartment and rental pool as a "single package," even if the parties offering them are unaffiliated, then the investment possibly amounts to the purchase of a "security" as defined in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). *Ante* at 11649-52. The majority is thus unwilling to grant summary judgment in favor of Dubois, believing that Hocking has raised material issues of fact regarding whether the condominium apartment and rental pool were marketed as a package and whether the sale involved an investment of money in a common enterprise with an expectation of profits produced by the efforts of others. *Ante* at 11652-60.

Unlike the majority, I believe that holding a real estate broker liable for the sale of an individual condominium apartment strays too far from the dominating purpose of the Securities Act of 1933 and the Securities Exchange Act of 1934: "to regulate the schemes devised by those who seek the *use* of the money of others with the lure of profits." Note,

Federal Securities Registration of Condominiums: A Purchaser's Perspective, 62 Geo. L.J. 1403, 1405 (1974) (emphasis added); *see United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 849 (1975) (focus of the Acts is on the unregulated "sale of securities to raise capital for profit-making purposes"); *SEC v. W.J. Howey Co.*, 328 U.S. at 299 (purpose of the Acts is to regulate the conduct of those "who seek the use of the money of others on the promise of profits"). Individual sellers of condominiums do not attract purchasers in order to put their money to "use"; they are instead selling them a tangible asset. In my view, therefore, the Acts reach only the rental pool operator's offering of collateral agreements that induce condominium owners to forego the personal use of their apartment on the promise of profits to be derived from a common enterprise in which they lack any effective control. The essential factor of a collateral agreement is absent anytime an individual owner sells his condominium without authority to bind the rental pool operator, exactly the situation here. For that reason, I respectfully dissent.

I

A

"[W]hen a purchaser is motivated by a desire to use or consume the item purchased—'to occupy the land or develop it themselves,' as the *Howey* Court put it—the securities laws do not apply." *Forman*, 421 U.S. at 852-53 (citation omitted). Accordingly, condominium apartments purchased for the purpose of occupying them as a residence do not involve investment contracts. Nor is this conclusion obviated simply because the property owner anticipates a normal appreciation in the value of the property and would not have consummated the purchase absent that expectation. *See Joyce v. Ritchie Tower Properties*, 417 F. Supp. 53, 54-55 (N.D. Ill. 1976) ("the sale of a condominium unit to be occupied by the plaintiff as his residence," even though he was expecting its

appreciation in value, did not involve the sale of a security). The logic of this conclusion is irrefutable: "A piece of real estate, such as a condominium, has an inherent worth," and its appreciation depends more on economic variables than it does "on the efforts of a promoter." *Bender v. Continental Towers Ltd. Partnership*, 632 F. Supp. 497, 501 (S.D.N.Y. 1986); *accord Dumbarton Condominium Ass'n v. 3120 R Street Assoc. Ltd Partnership*, 657 F. Supp. 226, 230 (D.D.C. 1987); *Mosher v. Southridge Assocs., Inc.*, 552 F. Supp. 1231, 1232 (W.D. Penn. 1982); *Johnson v. Nationwide Indus., Inc.*, 450 F. Supp. 948, 953 (N.D. Ill. 1978).

But a far more troubling situation arises where, as here, an investor purchases a condominium apartment expecting its appreciation in value and using it only intermittently as a vacation home, and yet finances the investment through rental income derived from the efforts of others. This type of transaction possesses some qualities of an investment whose success depends on the efforts of others, but it equally possesses qualities of an investment whose success depends on economic variables well beyond the control of the promoter. Like other real estate investments, the arrangement could fail if the anticipated appreciation is not ultimately realized; equally true, the arrangement could collapse if the rental proceeds are insufficient to sustain the finance costs of the initial purchase. Logically, the federal securities laws ought to afford a measure of protection to investors who are misled by false projections of rental income, *see* Rosenbaum, *The Resort Condominium and the Federal Securities Laws—A Case Study in Governmental Inflexibility*, 60 Va. L. Rev. 785, 796 (1974) ("purchasers should be furnished information bearing on [a promoter's] competence in operating resort rental facilities"), but not for investors who are disappointed because economic variables[18] fail to yield an expected appre-

[18]Distinguishable, of course, are those cases holding that an investment contract exists when the appreciation in the value of the real estate is derived from the efforts of a developer rather than ordinary economic fac-

ciation in the value of the condominium, *see Bender*, 632 F. Supp. at 501.

B

The Securities and Exchange Commission ("Commission") has itself struggled for many years with the mechanics of this type of transaction, offering in 1973 the following guidelines as a solution:

> In summary, the offering of condominium units in conjunction with any one of the following will cause the offering to be viewed as an offering of securities in the form of investment contracts:
>
> 1. The condominiums, with any rental arrangement or other similar service, are offered and sold with emphasis on the economic benefits to the purchaser to be derived from the managerial efforts of the promoter, or a third party designated or arranged for by the promoter, from rental of the units.
>
> 2. The offering of participation in a rental pool arrangement; and
>
> 3. The offering of a rental or similar arrangement whereby the purchaser must hold his unit available for rental for any part of the year, must use

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tors. *See, Aldrich v. McColluch Properties, Inc.*, 627 F.2d 1036, 1039 n.1 (10th Cir. 1980) ("Capital appreciation through development should be distinguished from a general increase in land values concurrent with neighborhood growth and improvements"); *cf. SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 349 (1943) (the capital appreciation in investors' leases depended on a promoter's efforts in drilling a test oil well). *See generally* 1 L. Loss, *Securities Regulation* 491-92 (2d ed. 1961).

> an exclusive rental agent or is otherwise materially restricted in his occupancy or rental of his unit.

Guidelines as to the Applicability of the Federal Securities Laws to Offers and Sales of Condominiums or Units in Real Estate Development, Securities Act Release No. 33-5347, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,163, at 82,539-40 (Jan. 4, 1973) (hereinafter "Release No. 33-5347"). Each of these types of real estate transactions, according to the release, involve investments with business emphasis and therefore are appropriately the subject of the federal securities laws. *But see* Note, *The Economic Realities of Condominium Regulation Under the Securities Act of 1933*, 19 Ga. L. Rev. 747 (1985) (stressing that the guidelines should be revised because they unduly stress promoters' profit motives in attracting purchasers rather than the economic reality of the condominium owner's retained control over the rental arrangements for his apartment).

In its *amicus curiae* brief, the Commission takes the position that the views expressed in its release apply only to persons engaged in the business of building and selling condominium apartments. Further, the Commission argues that, although unstated in the release, the sale of an individual condominium apartment cannot constitute the sale of a security, even if the buyer anticipated enrollment in a rental pool, absent an affiliation between the condominium seller and the rental pool operator. The majority dismisses this view merely as an interpretation of the Commission's 1973 release. *Ante* at 11650. That release, however, represents the Commission's interpretation of the federal securities Acts and is, therefore, to be accorded "great weight"; the Commission's interpretation of its own release is, in my view, entitled to equal deference. *Cf. Forman*, 421 U.S. at 858 n.25.

The majority dismisses the Commission's view nonetheless, perceiving it as an attempt to "pull apart the package into separate transactions," neither of which, according to the

logic of the majority's argument, could alone constitute the sale of an investment contract. *Ante* at 11650-51. This view, however, unknowingly adopts the Commission's previously stated conclusion that, "where an investment contract is present, it consists of the agreement offered and the condominium itself." Release No. 33-5347, at 82,536 n.1. But as one commentator has aptly observed, this conclusion implies, illogically, that a condominium owner who joins a rental pool sometime after the initial purchase thereby invests in a security consisting of both the condominium apartment and the rental pool agreement. *See* Rosenbaum, 60 Va. L. Rev. at 791. For example, had the Libermans enrolled in the rental pool rather than place their condominium on the real estate market, the Commission, and presumably the majority, would assert that they had invested in a "security" consisting of both the condominium and the rental agreement. The problem with this theory, of course, is that the condominium apartment, already belonging to the Libermans, is not what they would have "received" in return for their investment. Quite the contrary, use of the condominium apartment is what they would have "given up" in exchange for the opportunity to profit from the rental pool.

The better interpretation, the only one that makes logical sense given the Commission's position in its *amicus curiae* brief, is that the "investment contract" consists only of the rental agreement itself and not of the condominium apartment and the rental agreement combined. The same is true regardless of whether the condominium apartment and the rental agreement are marketed, in the words of the majority, as a "single package," or whether they are marketed separately. Thus, the initial purchase of the condominium apartment, even if the buyer anticipates enrollment in a rental pool, does not implicate the federal securities laws. Once the buyer commits the use of the condominium apartment to the rental pool, however, that act constitutes an exchange of value that satisfies the first prong of the *Howey* test. *See International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 560 n.12

(1979) ("This is not to say that a person's 'investment,' in order to meet the definition of an investment contract, must take the form of cash only, rather than of goods and services."); *Hector v. Wiens*, 533 F.2d 429, 432 (9th Cir. 1976) ("an 'investment of money' means only that the investor must commit his assets to the enterprise in such a manner as to subject himself to financial loss"). Whether the second and third prongs of the *Howey* analysis are satisfied would, of course, depend on the type of rental agreement involved and the amount of control retained by the condominium apartment owner. *E.g., Cameron v. Outdoor Resorts of Am., Inc.*, 608 F.2d 187, 191-92 (5th Cir. 1979) (holding an investment contract where a promoter was given "the exclusive right to rent the [condominium] campsite in the absence of the owner and his guests"), *aff'd on reh'g*, 611 F.2d 105 (5th Cir. 1980); *see* Note, 19 Ga. L. Rev. at 772-75 (economic realities of investment contracts depend on the type of rental agreement and the amount of control retained by the condominium owner).

This conclusion is fully consistent with the Supreme Court's decision in *Howey*. There, investors anticipated profits to be earned by the marketing of citrus products grown on their property. According to the Court, "[t]he resulting transfer of rights in land [was] purely incidental," even inconsequential, in the sense that the real estate was considered a component of the investment contract. 328 U.S. at 300. But the investors' foregoing of the use of their land, purchased only coincidentally from the same promoter, was critical to the exchange of value needed to enter the service contract. In other words, the "investment of money" needed for the first prong of the *Howey* test was not satisfied by paying the cost of the real estate and service contracts considered together, but rather by foregoing the use of an asset in order to commit it to the use of another on the promise of profits. *See id.* at 300-01.

C

As this case well demonstrates, absurd results attach to any other interpretation. If the condominium apartment is itself considered a component of the investment contract, its seller could be held liable for representations regarding its resale value even though that value has nothing to do with the "efforts of others." No justification exists for a resort condominium owner to have a federal remedy for losses of this sort while residential condominium owners are deprived of a similar remedy. State laws may offer protection for losses of this sort; the federal securities laws are not so designed.[19]

Moreover, the effect of concluding that a condominium apartment is a component of the investment contract is that neither real estate brokers who are unlicensed in the sale of securities nor securities brokers who are unlicensed in the sale of real estate can market the sale of an individual condominium apartment whose buyer is entitled to join a rental pool. *See* Rosenbaum, 60 Va. L. Rev. at 797-98. The individual owner, under these circumstances, will either have to market

[19]I find it appropriate at this juncture to repeat the admonition of the Supreme Court:

> It has been suggested that the sale of housing developments such as condominiums and cooperatives is in need of federal regulation and therefore the securities laws should be construed or amended to reach these transactions. Others have disagreed, claiming that the extensive body of regulation developed over more than four decades under these Acts would be inappropriate and unduly costly to the sellers and buyers of residential housing. Moreover, extension of the securities laws to real estate transactions would involve important questions as to the appropriate balance between state and federal responsibility. The determination of whether and in what manner federal regulation may be required for housing transactions, where the characteristics of an investment in securities are not present, is better left to Congress, which can assess both the costs and benefits of any such regulation.

Forman, 421 U.S. at 859 n.26 (citations omitted).

the unit himself, thereby defeating the stated purpose of promoting complete disclosure to potential buyers, or seek that elusive broker who is appropriately, yet needlessly, licensed in both fields. *See id.* at 801-02. Such a rule is, frankly, utter nonsense. *See generally* Berman & Stone, *Federal Securities Laws and the Sale of Condominiums, Houses, & Homesites*, 30 Bus. Law. 411, 412 (1975) (warning developers to "be prepared to deal with a misapplication of the securities acts to the conventional offer and sale of real estate units"); Comment, *Looking Through Form to Substance: Are Montana Resort Condominiums "Securities"?*, 35 Mont. L. Rev. 265 (1974) (emphasizing that the real estate transactions involved in the sale of resort condominiums is adequately protected by state laws and that compliance with securities regulations is either redundant or pointless).

Conversely, requiring promoters of rental pools to comply with the requirements of the federal securities acts, regardless of whether the target of their offering acquires the condominium directly from them or from previous owners, serves the legitimate purpose of regulating the conduct of those "who seek the use of the money of others on the promise of profits." *SEC v. W.J. Howey*, 328 U.S. at 299; *see* Note, 62 Geo. L.J. at 1413-28 (suggesting types of information that ought to be given to potential investors in rental pools). Equally important, placing the burden of compliance with the securities regulations on the promoter of the rental pool avoids the problem that real estate agents will otherwise encounter if they help prospective condominium purchasers obtain financing. *See* Rosenbaum, 60 Va. L. Rev. at 804-15. It may well be that investors will not consummate the purchase of condominium apartments without being told of the opportunity to join a rental pool. But the burden of disclosing the expected financial benefits of the rental pool is placed appropriately on its promoter and not on the individual condominium seller. Even the least sophisticated buyer would recognize that information provided by an individual condo-

minium seller has no greater value than any other "stock tip" provided by one investor to another.

D

In summary, I believe that an investor may have recourse in the federal securities laws only for losses he sustains after committing his condominium apartment to a rental pool whose promoter has not fully disclosed its financial advantages and disadvantages. That loss may, in appropriate circumstances, include the costs of financing the initial investment in the condominium. But I also believe that an investor cannot recover for these losses against the condominium seller or the seller's agent, nor can he recover under federal law for losses caused by an inadequate appreciation in the value of the condominium. Until Congress passes legislation otherwise, any remedy provided to condominium buyers against these parties or for this type of loss is, appropriately, a matter of state law.

II

If the law and facts in this case are as I perceive them, Hocking cannot recover against Dubois for two reasons. First, Hocking's claim is lodged against the wrong party—at least to the extent that he claims his profits from the rental pool failed to sustain, as allegedly promised, the costs of financing his condominium apartment. It is undisputed that Dubois, as the Libermans' real estate agent, lacked any authority to offer Hocking a rental agreement on behalf of the Hotel Corporation of the Pacific, Inc. ("HCP")—the promoter of the rental pool. Indeed, the record reveals that Hocking entered into the rental agreement directly with HCP sometime after purchasing the condominium. There is, therefore, no basis for holding that Dubois either had the capacity to, or in fact did, "offer" Hocking an investment contract. The party who made that offer, HCP, simply has not been named in this lawsuit.

Second, Hocking's theory of liability lies, for the most part, on the fact that the condominium apartment failed to appreciate in value as allegedly promised. Hocking does not deny that his entire motive in investing in this condominium apartment was to profit from its expected appreciation. Nor can he seriously deny that he was able to make his monthly payments on the condominium apartment—at least in part from the proceeds of the rental pool—up until the point that the "balloon" payment became due. The crux of his complaint, then, is that the condominium apartment was not sold before that time because it failed to appreciate in value as he had predicted. This claim is undoubtedly a matter of state law.

Dubois is entitled to summary judgment for both of these reasons. Accordingly, I would affirm the judgment of the district court.

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APPENDIX B

Order dated December 7, 1988 Withdrawing Original Decision of the Court of Appeals for the Ninth Circuit

B-1

FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

GERALD M. HOCKING, *Plaintiff-Appellant,* v. MAYLEE DUBOIS and VITOUSEK & DICK REALTORS, INC., a Hawaii corporation, *Defendants-Appellees.*	No. 85-1932 DC No. C-LV-83-835-HDM ORDER

Before: GOODWIN, Chief Judge, and BROWNING, SCHROEDER, FLETCHER, NELSON, NORRIS, WIGGINS, BRUNETTI, NOONAN, O'SCANNLAIN and TROTT, JJ.

The opinion filed in the above-entitled matter, published at 839 F.2d 560, on February 10, 1988, is withdrawn and the case is taken under submission by the en banc court.

APPENDIX C

Original Decision of the Court of Appeals for the Ninth Circuit dated February 10, 1988

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

GERALD M. HOCKING,
Plaintiff-Appellant,

v.

MAYLEE DUBOIS and VITOUSEK & DICK REALTORS, INC., a Hawaii corporation,
Defendants-Appellees.

No. 85-1932
D.C. No.
C-LV-83-835-HDM
OPINION

Appeal from the United States District Court
for the District of Nevada
Howard D. McKibben, District Judge, Presiding

Argued and Submitted
February 13, 1986—San Francisco, California

Filed February 10, 1988

Before: Alfred T. Goodwin, Procter Hug, Jr. and
Stephen Reinhardt, Circuit Judges.

Opinion by Judge Reinhardt; Dissent by Judge Hug

SUMMARY

Securities/Real Property

Appeal from judgment. Reversed and remanded.

Appeal from a grant of summary judgment on a securities claim and dismissal of pendent state claims.

Appellant Hocking met with appellee Dubois, a licensed real estate agent in Hawaii. She was employed by appellee Vitousek & Dick Realtors, Inc., a Hawaiian real estate brokerage firm. Dubois found a condominium in Hawaii for Hocking, owned by the Libermans, located in a complex developed by Aetna Life Insurance Company. As a part of the original development, Aetna had offered purchasers an opportunity to participate in a rental pool arrangement (RPA). This was optional and the Libermans had not participated in it. After Dubois advised Hocking of the availability of the RPA, Hocking purchased the condominium. Subsequently, he entered into a RPA. Ultimately, he filed suit alleging violations of the antifraud provisions of the Securities Exchange Act, Rule 10b-5, and state law claims. The district court granted summary judgment for defendants on the securities claim and dismissed the pendent state claims for lack of subject matter jurisdiction.

[1] A "security" is any "investment contract." [2] Under *Howey*, an investment contract consists of (1) an investment of money, (2) in a common enterprise, (3) with the expectation of profits produced by the efforts of others. [3] Real estate transactions may involve an offer of securities when an investor is offered both an interest in real estate *and* a collateral expectation of profits. [4] The SEC guidelines state unequivocally that it will view a condominium as a security if there is an offering of participation in a RPA. [5] The fact that Hocking's participation in the RPA was not compulsory does not preclude the finding of a security. [6] Even apart from the SEC guidelines, under the three *Howey* criteria an offer of a condominium with an RPA constitutes an offer of an investment contract. [7] In appellees' view, the condominium ceased to be a security at the time the Libermans purchased it because the Libermans chose not to participate in the RPA, and, therefore, the sale to Hocking did not involve the transfer of an interest in an RPA. [8] Just because the Libermans did not exercise their option to enter the RPA that came with their condominium does not mean that the option itself ceased to

exist. [9] What determines the applicability of the securities laws here is *what* tangible bundle of rights was actually offered to or purchased by the buyer, not *who* offered or sold those rights to him. [10] Furthermore, the SEC has refused to accede to the argument that there is no offer of a security even where the RPA terminates with the previous condominium owner. [11] Dubois, as Hocking's broker, may be held liable for misrepresentations she allegedly made to her client. Section 10(b) and Rule 10b-5 expressly extend to fraudulent statements made in connection with the purchase or sale of any security, regardless of who makes them.

The dissent argues that a broker who simply arranges for the sale of the unit and notifies the buyer that he may be able to enroll in the developer's rental pool is not offering a security.

COUNSEL

Patrick C. Clary, Las Vegas, Nevada, for the plaintiff-appellant.

John P. Foley and John C. Morrell, Las Vegas, Nevada, for the defendants-appellees.

OPINION

REINHARDT, Circuit Judge:

This is an action for fraud brought under the federal securities laws against a real estate agent and the broker that employed her. Appellant based federal jurisdiction on the claim that the real estate agent offered a "security" within the meaning of the federal securities laws. He also alleged pendent state causes of action for fraud. The district court

entered summary judgment, concluding that it lacked subject matter jurisdiction because no security was involved. On appeal, the central issue is whether the real estate agent's alleged conduct, if true, constituted the offering of an "investment contract" within the meaning of the federal securities laws. There is no dispute that the agent transmitted an offer to sell a condominium unit from the owner to the plaintiff. There is, however, a genuine issue of fact whether the offer included an option to participate in a rental pool operated by the developer of the condominium complex.[1] The question is whether that fact is a material one. We hold that it is, and that the offer of a condominium with an option to participate in a rental pool arrangement constitutes the offer of an investment contract under the securities laws. Accordingly, we reverse the grant of summary judgment.

I.

Gerald Hocking visited Hawaii and became interested in buying a condominium there as an investment. When he

[1]In her answer to Hocking's Third Amended Complaint, Dubois denies that the offer included an option to participate in a rental pool arrangement. The district court did not make a factual finding on this issue because it reasoned that the optional nature of the rental pool precluded the finding of a security. As discussed fully below, that reasoning was incorrect.

For convenience only and because hereafter we deal only with the legal issues involved, throughout the rest of our opinion we treat as an established fact plaintiff's claim that the offer included an option to participate in a rental pool arrangement. We do not actually make any such factual determination here. For purposes of summary judgment, we need only note that evidence in the record, when viewed in the light most favorable to Hocking, raises a genuine issue of material fact as to whether the offer included such an option. For example, Hocking stated that he had been informed of the availability of the rental pool arrangement by Dubois, and that he would not have purchased the condominium without the option. Further, within two weeks of purchasing the condominium, Hocking entered into the rental pool arrangement. Despite this evidence, the resolution of the factual issue must await a trial on the merits or a motion for summary judgment filed by Hocking.

returned to his home in Las Vegas, he made this known to a co-worker whose wife, Maylee Dubois, was a licensed real estate agent in Hawaii. She was employed by Vitousek & Dick Realtors, Inc., a Hawaiian real estate brokerage firm. A meeting was arranged between Hocking and Dubois. Subsequently, Dubois agreed to help Hocking find a suitable unit.

Dubois found a condominium unit owned by Tovik and Yaacov Liberman that was for sale. The unit was located in a resort complex developed by Aetna Life Insurance Company ("Aetna"). As a part of the original development, Aetna had offered purchasers an opportunity to participate in a rental pool arrangement ("RPA").[2] This was optional and the Libermans had not participated in the rental pool.

In arranging the sale of the Libermans' condominium, Dubois advised him of the availability of the rental pool arrangement. *See* note 1 *supra*. Hocking purchased the condominium unit from the Libermans on June 23, 1979. On July 5, 1979, Hocking entered into a rental management agreement with Hotel Corporation of the Pacific ("HCP") and a rental pool agreement that was to take effect six months later. Although the record is not clear on the relationship between HCP and the developer, Aetna, it appears that HCP performed management services at the option of the condominium purchasers.

Hocking subsequently filed suit alleging violations of the antifraud provisions of the Securities Exchange Act of 1934, 15 U.S.C. § 78j (1982), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (1987), and state law claims of fraud, negligence, and breach of fiduciary duty. He alleged

[2]Under an RPA, an agent is responsible for renting and managing the resort project. The rental income from the units is pooled, and after each owner is assessed a pro rata share of the agent's costs, each owner receives a pro rata share of the rental income whether or not the owner's individual unit actually was rented.

various acts of fraud by Dubois in inducing him to buy the unit and in services she performed or failed to perform thereafter. The district court granted summary judgment for defendants on the securities claim and dismissed the pendent state claims for lack of subject matter jurisdiction.

II.

We review the grant of summary judgment *de novo*. *SEC v. Belmont Reid & Co.*, 794 F.2d 1388, 1390 (9th Cir. 1986). Our task is identical to the trial court's: while viewing the evidence in the light most favorable to Hocking, we must determine whether the defendants have shown that there are no disputed issues of material fact and that they are entitled to judgment as a matter of law. *Alaska v. United States*, 754 F.2d 851, 853 (9th Cir.), *cert. denied*, 106 S. Ct. 333 (1985). We also review *de novo* the district court's determination whether a transaction is a security. *Belmont Reid & Co.*, 794 F.2d at 1390.

III.

[1] The term "security" is defined in section 2 of the Securities Act of 1933, 15 U.S.C. § 77b(1) (1982), and in section 3 of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10) (1982). The sections, which are substantially identical, *Tcherepnin v. Knight*, 389 U.S. 332, 335-36 (1967), define a security to include any "investment contract." However, the definition is not a static one. Congress cast it "in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security." H.R. Rep. No. 85, 73d Cong., 1st Sess. 11 (1933).[3] It embodies a

[3]The remedial purposes of the 1933 Act were expressed as follows:

> The aim is to prevent further exploitation of the public by the sale of unsound, fraudulent, and worthless securities through mis-

flexible principle "capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946); *see also United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975).

[2] The now classic definition of an investment contract is found in *SEC v. W.J. Howey Co.* In *Howey*, investors purchased portions of a citrus grove in Florida. The seller offered each investor a land sales contract and a service contract under which defendant cultivated, harvested, and marketed the fruit. The service contract was for a ten-year period with no option to cancel. The investors nominally owned the land, but had no right to specific fruit or to enter the land. Their rights were limited to the receipt of profits from the pooling of all the harvested fruit. 328 U.S. at 295-96. The Court noted that the buyers lacked the knowledge, skill, and equipment necessary in the citrus fruit business and that the only way they could hope for a return on their investment was by absolute reliance on the efforts and abilities of the Howey Company. *Id.* at 299-300. The Court, in finding an investment contract, held:

> [A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.

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representation; to place adequate and true information before the investor; to protect honest enterprise, seeking capital by honest presentation, against the competition afforded by dishonest securities offered to the public through crooked promotion. . . .

S. Rep. No. 47, 73d Cong., 1st Sess. 1 (1933).

328 U.S. at 298-99. Under *Howey*, then, an investment contract consists of (1) an investment of money, (2) in a common enterprise, (3) with the expectation of profits produced by the efforts of others.[4]

Generally, simple transactions in real estate, without more, do not satisfy the *Howey* criteria. *See, e.g., De Luz Ranchos Inv., Ltd. v. Coldwell Banker & Co.*, 608 F.2d 1297, 1301 (9th Cir. 1979) (defendants' only obligation to purchaser was to transfer title); *Woodward v. Terracor*, 574 F.2d 1023, 1025 (10th Cir. 1978) (same); *Mosher v. Southridge Associates*, 552 F. Supp. 1231, 1232 (W.D. Pa. 1982) (sale of condominium with no attendant restrictions); *Johnson v. Nationwide Industries*, 450 F. Supp. 948, 953 (N.D. Ill. 1978) (no allegation of a collateral arrangement in addition to the transfer of land), *aff'd*, 715 F.2d 1233 (7th Cir. 1983); *Happy Investment Group v. Lakeworld Properties, Inc.*, 396 F. Supp. 175, 180 (N.D. Cal. 1975) (defendants performed no skilled activities after land transferred). When a purchaser is motivated exclusively by a desire to occupy or develop the land personally, no security is involved. *See, e.g., Howey*, 328 U.S. at 300; *Joyce v. Ritchie Tower Properties*, 417 F. Supp. 53, 55-56 (N.D. Ill. 1976) (purchase of condominium as personal residence).

[3] Real estate transactions may involve an offer of securities when an investor is offered both an interest in real estate *and* a collateral expectation of profits. *See Forman*, 421 U.S. at 853 n.17. However, drawing the line between the offering of land sales contracts and investment contracts has not been easy. To resolve this difficulty, at least in the area of condominiums, the Securities and Exchange Commission issued

[4]This test has led courts to classify a wide variety of novel economic schemes as "investment contracts." *See, e.g., Smith v. Gross*, 604 F.2d 639, 642-43 (9th Cir. 1979) (per curiam) (earthworms); *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 478-85 (5th Cir. 1974) (cosmetics); *Miller v. Central Chinchilla Group, Inc.*, 494 F.2d 414, 416-18 (8th Cir. 1974) (chinchillas).

guidelines in 1973 on the applicability of federal securities laws to the burgeoning resort condominium market. *See* Offers and Sales of Condominiums or Units in a Real Estate Development, Securities Act Release No. 33-5347, 1 Fed. Sec. L. Rep. (CCH) ¶ 1049 (Jan. 4, 1973) (listed at 17 C.F.R. § 231.5347 (1987)). We read the *Howey* criteria in light of those guidelines.

[4] In Release 5347, the Commission states unequivocally that it will view a condominium as a security if it is offered with any one of three specified rental arrangements.[5] The second of these arrangements, the controlling one here, is "[t]he offering of participation in a rental pool arrangement." 38 Fed. Reg. 1735, 1736 (1973). Unlike a transaction covered under the first arrangement, the offering of a condominium with an RPA *automatically* makes the investment a security.[6]

[5]The release summarizes three situations which would involve the offering of a security:

> 1. The condominiums, with any rental arrangement or other similar service, are offered and sold with emphasis on the economic benefits to the purchaser to be derived from the managerial efforts of the promoter, or a third party designated or arranged for by the promoter, from rental of the units.
>
> 2. The offering of participation in a rental pool arrangement; and
>
> 3. The offering of a rental or similar arrangement whereby the purchaser must hold his unit available for rental for any part of the year, must use an exclusive rental agent or is otherwise materially restricted in his occupancy or rental of his unit.

38 Fed. Reg. at 1735, 1736 (1973).

[6]Whether the condominium is offered with emphasis on the benefits to be derived from the efforts of others is relevant only where there is a *non-pooled* rental arrangement. This is because only Arrangement 1 contains the phrase "emphasis on the benefits to the purchaser to be derived from the managerial efforts of [others]." It is clear that Arrangement 2 is meant to provide the exclusive coverage for RPAs. While the language of Arrangement 1 is general, ostensibly covering "any rental arrangement," giving that

[5] The district court, in its order granting summary judgment to Dubois, seems to have recognized that the second arrangement described in the SEC guidelines is the type of arrangement involved here. Nevertheless, the court decided that the rule governing the second arrangement was not controlling because the RPA at issue here was *optional*. This was incorrect. Whether Hocking was offered a security does *not* depend on the optional or discretionary nature of the RPA. Rather, it depends simply upon whether the offer included an RPA, so that the offeree, if he or she chose to participate, could do so. Indeed, in *Howey*, the investors were not required to enter into service contracts with the defendants. The investors were merely told that the investment was not feasible without a contract, and that the defendants' contract was superior to all others. 328 U.S. at 295. The Court's conclusion that the transaction was an investment contract was "unaffected by the fact that some purchasers choose not to accept the . . . service contract." *Id.* at 300. "[I]t is enough that the [defendants] merely *offer* the essential ingredients of an investment contract." *Id.* at 301 (emphasis added). Simi-

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phrase an all-inclusive interpretation would render meaningless the language of Arrangement 2.

The SEC makes this conclusion clear elsewhere in its guidelines. Compare, for example, the following two statements from the Release:

> The offer of the unit together with the offer of an opportunity to participate in such a *rental pool* involves the offer of investment contracts which must be registered unless an exemption is available. . . .
>
> . . .
>
> If the condominiums are not offered and sold with emphasis on the economic benefits to the purchaser to be derived from the managerial efforts of others, . . . an owner of a condominium unit may, after purchasing his unit, enter into a *non-pooled rental* arrangement . . . without causing a sale of a security to be involved in the sale of the unit.

1 Fed. Sec. L. Rep. (CCH) ¶ 1049 at 2071-2072 (1973) (emphasis added).

larly, the fact that Hocking's participation in the RPA was not compulsory would not preclude the finding of a security here. *See Cameron v. Outdoor Resorts of America, Inc.*, 608 F.2d 187, 193 (5th Cir. 1979) (investors could refuse to rent out their campsites or could rent them out personally), *on reh'g*, 611 F.2d 105 (5th Cir. 1980); *Wooldridge Homes, Inc. v. Bronze Tree, Inc.*, 558 F. Supp. 1085, 1087 (D. Colo. 1983) (defendant's managerial services were optional after initial two-year period).

Release 5347 is controlling here, and compels the conclusion that the offer of the condominium with an RPA option constituted the offer of a security.

IV.

[6] Even apart from the guidelines, we find that under the three *Howey* criteria an offer of a condominium with an RPA constitutes an offer of an investment contract.

1. *Investment of Money.* Defendants do not dispute that the condominium purchase satisfied *Howey's* first requirement. Hocking invested money in the condominium.

2. *Common Enterprise.* There has been some disagreement among the circuit courts of appeals on what satisfies the requirement of a common enterprise. *See Mordaunt v. Incomco*, 469 U.S. 1115, 1115-16 (1985) (White, J., dissenting from the denial of certiorari). Some require "horizontal commonality," usually evidenced by a pooling of assets from two or more investors into a single investment fund. *See, e.g., Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 622 F.2d 216, 222 (6th Cir. 1980), *aff'd on other grounds*, 456 U.S. 353 (1982); *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96, 100-01 (7th Cir. 1977); *Wasnowic v. Chicago Board of Trade*, 352 F. Supp. 1066, 1070 (M.D. Pa. 1972), *aff'd*, 491 F.2d 752 (3d Cir. 1973), *cert. denied*, 416 U.S. 994 (1974). The Fifth Circuit has rejected horizontal commonality in favor of

"vertical commonality" — focusing on investor dependence on promoter expertise rather than the fortuity of collective investments. *SEC v. Continental Commodities Corp.*, 497 F.2d 516, 522 (5th Cir. 1974); *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 478 (5th Cir. 1974). We accept both horizontal and vertical commonality.

Horizontal commonality describes the relationship shared by two or more investors who pool their investments together and split the net profits and losses in accordance with their pro rata investments. *See Brodt v. Bache & Co.*, 595 F.2d, 459, 460 (9th Cir. 1978). ("This pooling of interests, usually combined with a pro-rata sharing of profits, has been characterized as *horizontal* commonality." (emphasis in original)). By pooling their assets and giving up their claims to any profit or loss attributable to their particular investments, investors make their collective fortunes dependent on the success of a single common enterprise. Clearly, horizontal commonality describes the relationship that purchasers of a company's securities share with one another. This is the standard, run-of-the-mill situation for which the securities laws were designed to apply.

The strictest definition of common enterprise involves only horizontal commonality, i.e., an investor pooling assets with other investors. *Id.*; *see, e.g., Hirk*, 561 F.2d at 101. However, we define common enterprise more broadly, as a venture in which the "fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment *or of third parties*." *SEC v. Glenn W. Turner Ent., Inc.*, 474 F.2d 476, 482 n.7 (9th Cir.) (emphasis added), *cert. denied*, 414 U.S. 821 (1973); *Brodt*, 595 F.2d at 460. Vertical commonality does not require that several investors pool their funds. Rather, "vertical commonality requires that the investor and the promoter be involved in some common venture without mandating that other investors also be involved in that venture." *Brodt*, 595 F.2d at 461; (citing *Hector v. Wiens*, 533 F.2d 429, 433 (9th Cir. 1976)). When vertical

commonality is permitted, even a venture that has but a single investor can be a common enterprise if the promoter's remuneration depends on the success of the venture. To summarize, horizontal commonality describes a common enterprise among several investors, while vertical commonality describes a common enterprise between the investor and the seller, promoter or some other party. *See* L. Loss, *Fundamentals of Securities Regulation* 197 n.1 (1983).

When we embraced vertical commonality in *Brodt*, we did not state that we intended to *replace* horizontal with vertical commonality; rather, we broadened the meaning of common enterprise beyond the "strict pooling requirement" used by other circuits. 595 F.2d at 460.[7] In other words, we simply added an additional means of establishing a common enterprise, which comes into play only when there is no pooling of funds by several investors in a venture. *See El Khadem v. Equity Securities Corp.*, 494 F.2d 1224, 1229 (9th Cir.) (court looks first for horizontal and then vertical commonality), *cert. denied*, 419 U.S. 900 (1974).

A rental pool arrangement creates *horizontal* commonality with other parties involved in the RPA. If Dubois' offer to sell the condominium did not include the option of joining the RPA, then Hocking's investment in the condominium would

[7]Professor Loss explains the fact that vertical commonality is the broader of the two requirements:

> The broadest view is satisfied with "vertical commonality"; that approach recognizes a "common enterprise" between broker and customer, without insisting on any sort of pooling among customers' accounts. A stricter view does insist on such pooling: "horizontal commonality." The strictest view is not satisfied, at least with merely vertical commonality, unless the broker himself shares in the enterprise apart from his commissions. (citations omitted)

L. Loss, *Fundamentals of Securities Regulation* 255 (1983) (footnotes omitted).

be his alone and not an investment in a common venture. In the absence of other investors, there would be no horizontal commonality and following *Brodt*, it would be proper to move on to an examination of the vertical relationship involved. But, as we have noted earlier, we assume for purposes of this opinion that the offer of a condominium to Hocking did include an offer of an option to enter an RPA. Accordingly, horizontal commonality exists.

It is readily apparent that an RPA for condominiums is a common enterprise. Each investor buys one share — a condominium — in a common venture that pools the rents from all of the units. The success of each participant's individual investment clearly depends on the entire RPA's success. At least with respect to the common enterprise prong of *Howey*, this is precisely the reason why the SEC felt that an offer of a condominium with an option for RPA *automatically* constitutes the offer of a security.

3. *Expectation of Profits Produced by Others' Efforts.*

With respect to the third prong of *Howey*, i.e., the expectation of profits produced by the efforts of others, we conclude that this requisite is met *whenever* a condominium is sold with an RPA option. This is what the Commission has done in its guidelines for condominiums. The rationale of the SEC's *automatic* application of the securities laws to RPAs is not expressly set forth in the Release. However, in 1972 the Real Estate Advisory Committee, which the late former SEC Chairman William Casey established to address the applicability of the securities laws to real estate investments, published its recommendations and reasoning. *See* SEC, *Report of the Real Estate Advisory Committee* (1972). The Committee concluded that "where a rental pool is made available in the course of the offering, what is really being sold to the purchaser is an investment contract whereby profits are expected to be produced if at all, through the efforts of a party other than the purchaser-owner." *Id.* at 77-78. The Committee's

recommendations regarding condominiums were substantially adopted by the SEC in its 1973 guidelines. We believe that the logic underlying the Release is clear and provides the basis for the proper construction of *Howey*.

The SEC and its advisory committee recognized the wisdom of having a rule that would make the sale of all the condominiums in a particular condominium development subject to the securities laws or would exclude the sale of all those units — regardless of the fortuity of the individual economic expectations of the particular buyer. A rule, the applicability of which depended on the subjective intentions of each individual prospective purchaser of each separate unit, would be extremely difficult to administer and would be arbitrary inasmuch as it would make the seller's — and any broker's — liability depend on the undisclosed and often unformed thoughts of the buyer. Even a specific condominium unit could on one day be a security and the next not, depending on the investment attitudes of a particular prospective purchaser on a particular day. For these reasons the SEC's Real Estate Advisory Committee was willing to recommend "rather mechanical tests" with respect to condominium investments, which the SEC adopted in its guidelines. *Id.* at 78. We agree, and believe that the Release's bright line rule reflects the only proper interpretation of *Howey* as applied to condominiums. The purchase of a condominium with an RPA option thus meets the third *Howey* requisite that there be an expectation of profits based upon the entrepreneurial or managerial efforts of others.[8]

[8]The third *Howey* criterion originally was that profits from the investment ought to accrue "solely from the efforts of others." *Howey*, 328 U.S. at 301. However, neither the Court nor this circuit has applied this criterion rigidly. For example, we have found securities to exist when profits are made in part by the efforts of others, and in part through the efforts of the purchaser. *See SEC v. Glenn W. Turner Ent.*, 474 F.2d 476 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973). In *Glenn W. Turner Ent.*, we held that the *Howey* test should be construed to require that "the efforts made by those

Not only, then, does the alleged transaction at issue constitute the offer of a security under the SEC guidelines, but it also constitutes a security under the test set forth in *Howey*.

V.

We address appellee's argument that the condominium is not a security because it was not offered to Hocking by Aetna.

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other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." 474 F.2d at 482. When the Supreme Court next considered the *Howey* test in *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975), the Court appears to have assented to the reading proposed by *Turner*, omitting "solely" and including the modifiers "entrepreneurial or managerial" before "efforts." 421 U.S. at 852.

Just as the *Howey* test allows us to find the existence of a security when profits are expected from the purchaser's own efforts as well as from the efforts of others, it also allows us to find a security when profits are expected from appreciation of condominium value at time of resale as well as from the efforts of others. This latter situation characterizes the facts here, where profits from the investment in a condominium with an RPA may come from the 1) the condominium's pro rata share of net rents from the RPA, which depends upon the efforts of others, and 2) the appreciation on the condominium at the time of resale, which does not depend upon others' efforts.

The existence of these two avenues for profit also characterized the facts of *Howey*, where profits came from harvested fruit, but also from the increased value of the land over time. What was important there, as is important here, is that the profits during the period of ownership come from the entrepreneurial or managerial efforts of others, and that the efforts of those other than the investor are the "undeniably significant ones". *SEC v. Glenn W. Turner Ent.*, 474 F.2d at 482. *See also SEC v. Goldfield Deep Mines Co. of Nev.*, 758 F.2d 459, 464 (9th Cir. 1985); *Hector v. Wiens*, 533 F.2d 429, 433 (9th Cir. 1976) (per curiam). *Howey*, therefore, does not contemplate that profits must come only from the efforts of others, and not also from increased land values. Our reasoning is consistent with that of the SEC, for the guidelines contemplate that the offer of a condominium with an RPA option necessarily constitutes the offer of a security, irrespective of an expectation of profits from appreciation at the time of resale.

the developer, and that because Dubois was not Aetna's agent she could not be found liable for her actions under the securities laws. We address these two arguments separately.

[7] In appellees' view, the condominium ceased to be a security at the time the Libermans purchased it because the Libermans chose not to participate in the RPA, and, therefore, the sale to Hocking did not involve the transfer of an interest in an RPA. Thus, the gist of appellees' logic is that the condominium was not a security because there had been an intermediate buyer who chose not to participate in the RPA. A rule such as this for determining whether an investment is a security makes no sense in the context of condominiums, or, for that matter, of any investment.

[8] The fundamental problem with this reasoning is that it misperceives the nature of an option. According to Hocking, the rental pool arrangement was an optional arrangement available to anyone buying a unit in the condominium project. Any purchaser could choose whether to participate in the RPA at the time of purchase or at a later date. Similarly, any subsequent purchaser could elect to participate regardless of the prior owners' decisions.[9] There exists no logical reason for appellees' assumption that the option somehow mysteriously disappeared from the scene following the Libermans' purchase of the condominium. Just because the Libermans did not exercise their option to enter the RPA that came with their condominium does not mean that the option itself ceased to exist. Rather, the option, at least as it is described by Hocking, continued to exist, and Hocking obtained the

[9]While we use the term "option" here, we do not intend the term to connote that Hocking, or indeed the Libermans, had an absolute legal right to enter into the pooling arrangment without the consent of the rental pool manager. Here, as in *Howey*, it is of no significance that the pool operator retained some discretion, at least in theory, to refuse to contract with the realty owner. Rather, we must look, as the *Howey* court did, to the practical realities of the situation, and to whether an RPA option was actually offered. *See Howey*, 328 U.S. at 299-301.

right to exercise that option and enter the RPA as a part of his acquisition of the condominium.

The appellees seem to recognize that the optional nature of an RPA has nothing to do with whether a condominium is a security. However, they argue that, while the fact that the RPA was optional does not affect the characterization of the condominium as a security, somehow the fact that the Libermans did not exercise their option does. Both of these facts should be equally irrelevant to this characterization, just as should the fact that Hocking chose to exercise his option. If the optional nature is irrelevant, so must be the fact that an individual has chosen to exercise or not to exercise that option.

[9] Conceivably, appellees could be suggesting that no security was involved because the Libermans offered only the condominium and the rental pool manager offered the RPA. If so, we cannot agree with this view. What determines the applicability of the securities laws here is *what* tangible bundle of rights was actually offered to or purchased by the buyer, not *who* offered or sold those rights to him. Drawing distinctions based on the fact that one party offered the real estate and another the RPA is precisely the sort of form-over-substance interpretation that Congress, the SEC and the courts have sought to avoid through the broad drafting of the securities laws and their mandated liberal construction. In *Howey*, for example, there were two companies, one that sold the orange groves and another that managed the pooled growing and marketing of the oranges. This separation did not prevent the Court from finding that the two companies' products were offered together. *See* 328 U.S. at 296.

The same willingness to look to the substance of a transaction rather than its form is reflected directly in the SEC's treatment of resort condominium investments. Immediately after publication of the SEC's 1973 release on condominiums, one developer attempted to evade the reach of the

release by not including the rental pool arrangement in its advertisements and informing investors of the availability of a separate company's pooling program only after they expressed an interest in purchasing for investment purposes. The SEC obtained a permanent injunction against this practice. *SEC v. Marasol Properties*, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,159 (D.D.C. Sept. 28, 1973). As one commentator put it, *Marasol Properties* serves as "an effective warning to condominium developers that courts are willing to look beyond form to the economic realities and the substance of a scheme." Note, *Federal Securities Regulation of Condominiums: A Purchaser's Perspective*, 62 Geo. L.J. 1403, 1413 (1974).

[10] Furthermore, the SEC has refused to accede to the argument that there is no offer of a security even where the RPA terminates with the previous condominium owner. *Embarcadero*, SEC No-Action Letter, [1976-77 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,956 (Dec. 3, 1976). The argument was raised before the SEC by a local real estate broker, who inquired whether he would be subject to the securities laws if he resold units in a condominium project that had a rental pool arrangement. The units were originally registered as securities and sold on that basis. Upon sale of a unit the existing rental pool agreement terminated and the new purchaser was required to apply separately to enter the rental pool, without any assurance of acceptance and with the decision left to the discretion of the rental pool manager. The real estate broker's argument was that because the existing RPA terminated when a condominium was resold, the resale involved only the condominium and therefore was not a security. The SEC refused to issue a no-action ruling on these facts.[10] Thus, on facts far more favorable to the broker than

[10]While a no-action letter contains only the informal advice of SEC staff, it reflects what the staff's enforcement recommendation to the Commission will be if a transaction is consummated exactly as described in the response. *See* 17 C.F.R. § 200.81 (1986).

those presented here, the SEC declined to accept the view that a purchaser of a condominium with an RPA could somehow uncouple the two and sell only the condominium.

Finally, were courts to follow appellees' theory — that what was admittedly a security when offered by the issuer could cease to be one when it reaches the hands of a subsequent purchaser, merely because an intermediate buyer separates the two parties — the result would be erratic and inconsistent applications of the securities laws to condominium investments. A unit in a condominium project originally developed with an RPA would remain a security in the hands of successive purchasers until one chose not to use the RPA — although when a later purchaser of the same unit entered the RPA, the unit would again become a security. Conceivably, then, a unit could alternate between being a security and not being one as each successive purchaser made his individual decision whether to participate in the RPA. Applying this theory generally to investments other than condominiums would lead to equally absurd results. Moreover, a system of demarking the scope of the securities laws as ephemeral as this one would be far worse in its effect on condominium developers and brokers than would the more inclusive rule espoused by the SEC.[11] To hold that an offer of a condominium with an option to participate in an RPA is not an offer of a security, would therefore, make little practical or legal sense.

VI.

[11] We consider finally whether Dubois, as Hocking's broker, may be held liable for misrepresentations she allegedly made to her client. Section 10(b) and Rule 10b-5 expressly extend to fraudulent statements made "in connection with the purchase or sale of any security," regardless of who makes them. 15 U.S.C. § 78j(b)(1982); 17 C.F.R. § 240.10b-5. Thus,

[11] *See* discussion *supra* regarding the benefit of a bright line rule for the treatment of condominiums as securities.

liability under these antifraud provisions is not limited to the seller of a security or his agents; it includes all brokers regardless of whom they represent.

Because the condominium with its RPA is a security, Dubois acted as Hocking's securities broker. Just like any other purchaser of securities, Hocking may sue his own broker for fraudulent representations made in connection with the offer or sale of a security. *See, e.g., Hatrock v. Edward D. Jones & Co.*, 750 F.2d 767 (9th Cir. 1984) (broker's misrepresentation of rumor as fact supported finding of section 10(b) violation); *Toombs v. Leone*, 777 F.2d 465 (9th Cir. 1985) (broker not liable because no material misstatement or omission made). It is relatively common for securities purchasers to sue their own brokers; often, the sellers of the securities are not even known, let alone the sellers' brokers. A security broker's liability is not dependent on whether the seller is a defendant in the action or whether the broker acted as the seller's agent.[12] Of course, Dubois' liability will depend on whether Hocking can show a fraudulent representation or other violation of a duty owed by Dubois to Hocking. That issue is not before us now.

Accordingly, the judgment below is reversed and the case is remanded for further proceedings consistent with this opinion.

REVERSED AND REMANDED.

[12]The reach of the rule that a person not connected with the seller who makes misleading statements that affect a securities purchase can be sued under section 10(b) and Rule 10b-5 is illustrated by one recent case, in which a columnist for the Wall Street Journal was found criminally liable for a 10(b) violation. *United States v. Carpenter*, 791 F.2d 1024 (2d Cir. 1986), *aff'd by an equally divided Court*, 106 S. Ct. 316 (1987). A number of years earlier our court reached a similar conclusion in a civil case. *Zweig v. Hearst Corp.*, 594 F.2d 1261 (9th Cir. 1979). The offer of a security by a real estate broker is well within this rule.

HUG, Circuit Judge, dissenting:

I respectfully dissent.

The essential issue in this case is whether an "investment contract" was offered to Hocking. The majority correctly notes that, under some circumstances, a real estate offering can constitute an "investment contract" and thus a "security" within the meaning of the federal security laws. The Supreme Court has defined an investment contract in *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946), as follows:

> [A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party . . . .

My basic disagreement with the majority is that while the securities laws may well extend to a promotion by a developer who offers a condominium with a management arrangement giving the buyer the comfort of doing nothing but collecting the checks from the developer's efforts, they do not extend to this attenuated transaction. The Libermans sold their unit to Hocking. They had no authority to commit Aetna or HCP to allow Hocking to participate in the rental pool. Although Aetna may well have offered the Libermans an investment contract, the Libermans did not buy the investment contract; they simply bought a parcel of real property. That is all they were selling—a parcel of real property.

Just because a prospective buyer may be able to reach an arrangement with the developer's rental pool to rent his unit, this surely does not mean that any time a unit owner simply sells his unit, one year, ten years, or thirty years thereafter, he is selling a security. For the same reason, a broker who simply arranges for the sale of the unit and notifies the buyer that he may be able to enroll in the developer's rental pool is not

offering a security. This is a real estate transaction and is properly governed by real estate law.

The majority's analysis extends the concept of an "investment contract" well beyond the Supreme Court's interpretation in *Howey*. The *Howey* test is designed to cover the situation where the investor is induced to buy a parcel of real estate because the promoter is offering to make his investment profitable through management of the real estate. In *Howey*, the buyer of the ten acres of orange grove land in the middle of an orchard was relying, not on the intrinsic value of the ten acres or the use to which he could put them, but instead upon the promoter to tend and harvest the oranges and send him a check for the proceeds.

The SEC has applied this principle to condominiums. SEC Release 5347 seeks to establish the rules governing when such a promoter must register his condominium project as a security. It is a rather breezy release, in letter style, setting forth some bright line rules for when condominium developers must register their projects. As the release notes in its footnote 1, "where an investment contract is present, it consists of the agreement offered and the condominium."

The release is intended to notify developers of a bright line rule of when they must register their projects. It purports to apply *Howey* and *Joiner* and is reasonably accurate when it states:

> In other words, condominiums, coupled with a rental arrangement, will be deemed to be securities if they are offered and sold through advertising, sales literature, promotional schemes or oral representations which emphasize the economic benefits to the purchaser to be derived from the managerial efforts of the promoter, or a third party designated or arranged for by the promoter in renting the units.

But it moves away from the *Howey* concept and its own reasoning when it states in the following paragraph that the mere offering of a condominium in conjunction with participation in a rental pool arrangement "will cause the offering to be viewed as an offering of securities in the form of investment contracts."

While the Supreme Court has cited the release, *see Forman*, 421 U.S. at 853 n.17, it has expressed no opinion on the SEC's interpretation of *Howey*. Several writers have challenged that interpretation. *See, e.g.*, Rosenbaum, *The Resort Condominium and the Federal Securities Laws—A Case Study in Governmental Inflexibility*, 60 Va. L. Rev. 785 (1974); Comment, *The Economic Realities of Condominium Registration Under the Securities Act of 1933*, 19 Ga. L. Rev. 747 (1985); Comment, *Looking Through Form to Substance: Are Montana Resort Condominiums "Securities"?*, 35 Mont. L. Rev. 265 (1974). Although I have some doubts whether the mere offer by a developer of a rental pool, regardless of promotional emphasis, truly meets the *Howey* test (or satisfies the release's earlier reasoning), we need not determine that issue because we are not concerned with a developer who is offering a complete package of a condominium and a rental pool that is operated by or arranged for by the developer. We are here concerned with a condominium owner who has no connection whatsoever with a rental pool.

The majority applies SEC Release 5347 to a broker who extends the offer of an individual homeowner to sell his unit because the offer includes an "*option*" to participate in a rental pool of the original developer. It is most doubtful that the SEC release was designed to apply to this circumstance, and even more doubtful that the *Howey* test could apply.

An even more fundamental objection, however, is the fact that there exists no evidence that the Libermans had, or Dubois offered, such an "*option*." The entire majority opinion is premised on the conclusion that there exists a genuine

issue of material fact as to whether the offer from the Libermans that was communicated to Hocking included an "*option*" to participate in the rental pool operated by the developer. (See page 2 and footnote 1.) I find no evidence in the record that even suggests an option was offered. The Libermans had not participated in the rental pool themselves. They simply bought a condominium and were selling that condominium. Dubois was the real estate agent who communicated the Libermans' offer to sell the condominium to Hocking. She also alerted Hocking to the existence of the developer's rental pool. There is no evidence in the record that the Libermans had a transferable "*option*" to enter the rental pool that was binding on the developer, nor that Dubois communicated an offer of such an "*option*" along with the offer to sell the condominium.

The evidence cited by the majority in footnote 1 does not support a finding that an "*option*" was offered. Hocking's statement that he had been informed of the availability of the developer's rental pool is no indication that Dubois offered, or that the Libermans were able to convey, an enforceable option for a new purchaser to enter the rental pool. Nor does the fact that Hocking eventually enrolled in the rental pool provide such evidence.

In summary, I submit that, regardless of the validity of the SEC's bright line rule for the purpose of requiring developers to register their projects, it makes no sense to apply that rule to this case. Here we have the Libermans, who bought a unit, rejected the rental pool, and now seek to sell the unit. Dubois notified Hocking that if he bought the unit he could perhaps participate in the developer's rental pool. It is hard to envision either the Libermans or Dubois as promoters offering the kind of package that constitutes an "investment contract," as defined by the Supreme Court.

I would affirm the dismissal for lack of subject matter jurisdiction because no security was involved.

APPENDIX D

Order of the United States District Court for the District of Nevada, dated March 20, 1985

D-1

UNITED STATES DISTRICT COURT

DISTRICT OF NEVADA

GERALD M. HOCKING, *Plaintiff,* v. MAYLEE DUBOIS and VITOUSEK & DICK REALTORS, INC., a Hawaii corporation, *Defendants.*	CV-LV-83-835-HDM ORDER

Plaintiff Gerald Hocking commenced this action against Maylee Dubois and Vitousek and Dick Realtors, Inc. Hocking alleges violations of the Securities Exchange Act of 1934, 15 U.S.C. § 78j and Rule 10b-5. The Complaint also alleges several pendente state claims. This matter is before the court on Defendants' Motion for Summary Judgment under Fed. R. Civ. P. 56.

In 1979 the plaintiff entered into a real estate contract with Tovik Liberman and Yaacov Liberman for the purchase of certain property in Honolulu, Hawaii. The sellers of the property, Libermans, had purchased the property from the original developers and had owned the property for their personal use until the sale. The plaintiff purchased the property from Libermans for investment purposes. Plaintiff alleges that at the time of the sale he was advised by Dubois that he could enter into a rental pooling arrangement. Subsequent to entering into the sale agreement, plaintiff entered into a rental pooling agreement with Hotel Corporation of the Pacific. The Defendant Dubois is the Las Vegas agent for Defendant Vitousek and Dick Realty, a Hawaii corporation, who had the listing on the property. Plaintiff alleges that Dubois offered and included a rental pool agreement for the condominium with emphasis on the economic benefits to

plaintiff to be derived from the managerial efforts of third parties designated and arranged for by Defendant Dubois. Essentially, plaintiff maintains that Dubois misrepresented (1) that the plaintiff would be the first purchaser when in fact he was the second purchaser, (2) that the value of the property was overstated during the three year period of investment. (3) that the plaintiff was induced to list the property in 1981 at a price far above the market value.

Defendants, in their Motion for Summary Judgment, allege that the transaction did not involve a security within the meaning of Rule 10b-5 and since there is no federal claim which survives, the pendente state causes of action must also be dismissed.

Title 15 U.S.C. § 78j(b) and Rule 10b-5 prohibit the use of fraudulent or deceptive devices with the purchase or sale of a security.[1]

A resolution of defendants' Motion for Summary Judgment turns on whether the transaction in question was an investment contract under the *Howey* test. In *SEC v. W.J. Howey*, 328 US 293, 298-99, 66 S.Ct. 1100, 90 L. Ed. 1244 (1946), a three-pronged test for investment contracts was established. There must be (1) an investment of money (2) in a common enterprise and (3) an expectation of profits from the managerial efforts of others. A common enterprise is one

[1] Section 78j(b) providers: It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails or of any facility of any National Securities Exchange - (sub b) to use or employ in connection with the purchase or sale of any security registered on a National Securities Exchange or any security not so registered any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. Rule 10b-5 provides: It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality or interstate commerce, or of the mails or of any facility of any National Securities Exchange, (a) to employ any device, scheme or artifice to defraud (b) to make any untrue statement of a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) to engage in any act, practice or course of business which operates or would operate as a fraud or deceipt (*sic*) upon any person, in connection with the purchase or sale of any security.

in which the fortunes of the investor are interdependent on the efforts and success of those seeking the investment or of a third party. The efforts made by those other than the investor must be significant ones which effect (sic) the failure or success of the enterprise. *DeLuz Ranchos Inv. v. Caldwell Banker and Co.*, 608 F.2d 1297 (9th Cir. 1979). As a general rule the offer or sale of condominium property does not by itself constitute a security transaction. See SEC no-action letter, *in re* Surftides Condominiums, Inc. (February 7, 1972), (CCH) Fed. SEC. L. Rep. 78-686. The Securities and Exchange Commission has articulated the subject matter of the collateral agreements as they relate to condominium sales: (1) the condominiums with any rental agreement or similar service are offered and sold with emphasis on the economic benefits to the purchaser to be derived from the managerial efforts of the promoter, or a third party designated or arranged for by the promoter, from rental of the units; (2) the offering of participation in a rental pool agreement; and (3) the offering of a rental or similar agreement whereby the purchaser must hold his unit available for rental for any part of the year, and must use an exclusive rental agent, or is otherwise materially restricted in his occupancy or rental of his unit. SEC Securities Act Release No. 33-5347, 17 C.F.R. 231, 38 Fed. Reg. 1735 (Jan. 18, 1973), CCH Fed. SEC L. Rep. 1049.

In the instant action the purchase of the condominium unit by the plaintiff was not conditioned upon plaintiff's participation in any rental agreement. The plaintiff did decide to enter into a rental pooling agreement but was not required to do so as a condition of the sale or purchase of the property. Additionally, the seller of the property was not involved in any rental pooling agreement and the party with whom the plaintiff ultimately entered into the rental pooling agreement is not named as a party defendant to the instant action. The plaintiff has only joined the real estate agent in Las Vegas and the cooperative broker in Hawaii as party defendants on the grounds that they induced him to enter into the rental pooling agreement. Second, the decision to rent or not to rent the condominium was within plaintiff's sole discretion. There are no terms or conditions in the sales

agreement which require the plaintiff to rent the property or to use any particular rental agent to rent the property. It is true that it was represented to the plaintiff at the time of the sale that he could enter into a pooling agreement.

The decision on whether to do so was the plaintiff's and the sale was not conditioned on any such agreement. It was purely discretionary with the plaintiff as to whether or not he would enter into such a pooling agreement, and was not a condition of the sale of the unit. In fact, the sellers had no interest in the pooling agreement. Finally, under the rental agreement, plaintiff was not restricted from the use of his own unit and plaintiff had the responsibility to keep the unit in good repair and condition. Therefore, this Court finds that the mere representations by the defendants that there was a rental pooling agreement available which the plaintiff could enter into if he saw fit to do so subsequent to purchasing the property, is insufficient to establish a cause of action against these named defendants. There is no evidence that any of these defendants derived any economic benefit from such an agreement. The only economic benefit derived by the defendants was the commission derived from the sale of the property by a third party, Libermans, who were not a party to the rental agreement. This Court recognizes that this case poses a relatively close question of law since the rental pooling agreement was discussed prior to the sale and entered into right after the sale. Therefore, this action lies close to the edge of those transactions which have been found to be regulated by the Securities Act as investment contracts. Nevertheless, this Court believes that to extend the Securities Act to the facts of this case in which the party entering into the pooling agreement with the plaintiff is not even a named defendant in the action, and none of the defendants have been shown to be agents of Hotel Corporation of the Pacific or derived any benefit from the pooling agreement contract, would be too broad an extension of the Securities Act. *Mosher v. Southridge Associates, Inc.*, 552 F.Supp. 1231 (1982). Accordingly, Defendants' Motion for Summary Judgment on the Securities Act claim is granted and the Plaintiff's Third Amended Complaint will be dismissed along with the pen-

dente state claims. See *United Mine Workers of America v. Gibbs*, 383 US 715, 86 S.Ct. 1130, 16 L. Ed. 2d 218 (1966). This shall not preclude the plaintiff from commencing an appropriate state action to recover on alleged damages from the defendants.

Dated this 20th day of March, 1985.

/s/ HOWARD D. McKIBBEN
UNITED STATES DISTRICT JUDGE

APPENDIX E

Text of Section 3(a)(10) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. Section 78a(c)(10)

"(10) The term 'security' means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, *investment contract,* voting-trust certificate, certificate of deposit, for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a 'security'; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."

APPENDIX F

Securities Act Release No. 33-5347, 17 C.F.R. 231, 38 Fed. Reg. 1735, 1 Fed.Sec.L.Rep. (CCH) ¶ 1049 (Jan. 4, 1973)

OFFERS AND SALES OF CONDOMINIUMS OR UNITS IN A REAL ESTATE DEVELOPMENT

Release No. 33-5347, January 4, 1973, 38 F.R. 1735.

17 CFR 231.5347.

The Securities and Exchange Commission today called attention to the applicability of the federal securities laws to the offer and sale of condominium units, or other units in a real estate development, coupled with an offer or agreement to perform or arrange certain rental or other services for the purchaser. The Commission noted that such offerings may involve the offering of a security in the form of an investment contract or a participation in a profit sharing arrangement within the meaning of Securities Act of 1933 and the Securities Exchange Act of 1934.[1] Where this is the case any offering of any such securities must comply with the registration and prospectus delivery requirements of the Securities Act, unless an exemption therefrom is available, and must comply with the anti-fraud provisions of the Securities Act and the Securities Exchange Act and the regulations thereunder. In addition, persons engaged in the business of buying or selling investment contracts or participations in profit sharing agreements of this type as agents for others, or as principal for their own account, may be brokers or dealers within the meaning of the Securities Exchange Act, and therefore may be required to be registered as such with the Commission under the provisions of Section 15 of that Act.

The Commission is aware that there is uncertainty about when offerings of condominiums and other types of similar units may be considered to be offerings of securities that should be registered pursuant to the Securities Act. The purpose of this release is to alert persons engaged in the business of building and selling condominiums and similar types of real estate developments to their responsibilities under the Securities Act and to provide guidelines for a determination of when an offering of condominiums or other units may be viewed as an offering of securities. Resort

[1] It should be noted that where an investment contract is present, it consists of the agreement offered and the condominium itself.

condominiums are one of the more common interests in real estate the offer of which may involve an offering of securities. However, other types of units that are part of a development or project present analogous questions under the federal securities laws. Although this release speaks in terms of condominiums, it applies to offerings of all types of units in real estate developments which have characteristics similar to those described herein.

The offer of real estate as such, without any collateral arrangements with the seller or others, does not involve the offer of a security. When the real estate is offered in conjunction with certain services, a security, in the form of an investment contract, may be present. The Supreme Court in *Securities and Exchange Commission v. W.J. Howey Co.*, 328 U.S. 293 (1946) set forth what has become a generally accepted definition of an investment contract:

> "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise." (298)

The *Howey* case involved a sale and operation of orange groves. The reasoning, however, is applicable to condominiums.

As the Court noted in *Howey*, substance should not be disregarded for form, and the fundamental statutory policy of affording broad protection to investors should be heeded. Recent interpretations have indicated that the expected return need not be solely from the efforts of others, as the holding in *Howey* appears to indicate.[2] For this reason, an investment contract may be present in situations where an

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[2] *SEC v. Glenn W. Turner Enterprises, Inc.*, CCH Fed.Sec.Law Rep. ¶93,605 (D.C. Ore. No. 72-390, May 25, 1972). See also *State v. Hawaii Market Center, Inc.*, 485 P.2d 105 (1971) (cited in Securities Act Release No. 5211 (1971); and Securities Act Release No. 5018 (1969) regarding the applicability of the federal securities laws to the sale and distribution of whiskey warehouse receipts.

investor is not wholly inactive, but even participates to a limited degree in the operations of the business. The "profits" that the purchaser is led to expect may consist of revenues received from rental of the unit; these revenues and any tax benefits resulting from rental of the unit are the economic inducements held out to the purchaser.

The existence of various kinds of collateral arrangements may cause an offering of condominium units to involve an offering of investment contracts or interests in a profit sharing agreement. The presence of such arrangements indicates that the offeror is offering an opportunity through which the purchaser may earn a return on his investment through the managerial efforts of the promoters or a third party in their operations of the enterprise.

For example, some public offerings of condominium units involve rental pool arrangements. Typically, the rental pool is a device whereby the promoter or a third party undertakes to rent the unit on behalf of the actual owner during that period of time when the unit is not in use by the owner. The rents received and the expenses attributable to rental of all the units in the project are combined and the individual owner receives a ratable share of the rental proceeds regardless of whether his individual unit was actually rented. The offer of the unit together with the offer of an opportunity to participate in such a rental pool involves the offer of investment contracts which must be registered unless an exemption is available.

Also the condominium units may be offered with a contract or agreement that places restrictions, such as required use of an exclusive rental agent or limitations on the period of time the owner may occupy the unit, on the purchaser's occupancy or rental of the property purchased. Such restrictions suggest that the purchaser is in fact investing in a business enterprise, the return from which will be substantially dependent on the success of the managerial efforts of other persons. In such cases, registration of the resulting investment contract would be required.

In any situation where collateral arrangements are coupled with the offering of condominiums, whether or not specifically of the types discussed above, the manner of offering and economic inducements held out to the prospective purchaser play an important role in determining whether the offerings involve securities. In this connection, see *Securities and Exchange Commission v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943). *In Joiner,* the Supreme Court also noted:

> "In enforcement of [the Securities Act], it is not inappropriate that promoters' offerings be judged as being what they were represented to be." (353)

In other words, condominiums, coupled with a rental arrangement, will be deemed to be securities if they are offered and sold through advertising, sales literature, promotional schemes or oral representations which emphasize the economic benefits to the purchaser to be derived from the managerial efforts of the promoter, or a third party designated or arranged for by the promoter, in renting the units.

In summary, the offering of condominium units in conjunction with any one of the following will cause the offering to be viewed as an offering of securities in the form of investment contracts:

1. The condominiums, with any rental arrangement or other similar service, are offered and sold with emphasis on the economic benefits to the purchaser to be derived from the managerial efforts of the promoter, or a third party designated or arranged for by the promoter, from rental of the units;

2. The offering of participation in a rental pool arrangement; and

3. The offering of a rental or similar arrangement whereby the purchaser must hold his unit available for rental for any part of the year, must use an exclusive rental agent or is otherwise materially restricted in his occupancy or rental of his unit.

In all of the above situations, investor protection requires the application of the federal securities laws.

If the condominiums are not offered and sold with emphasis on the economic benefits to the purchaser to be derived from the managerial efforts of others, and assuming that no plan to avoid the registration requirements of the Securities Act is involved, an owner of a condominium unit may, after purchasing his unit, enter into a non-pooled rental arrangement with an agent not designated or required to be used as a condition to the purchase, whether or not such agent is affiliated with the offeror, without causing a sale of a security to be involved in the sale of the unit. Further a continuing affiliation between the developers or promoters of a project and the project by reason of maintenance arrangements does not make the unit a security.

In situations where commercial facilities are a part of the common elements of a residential project, no registration would be required under the investment contract theory where (a) the income from such facilities is used only to offset common area expenses and (b) the operation of such facilities is incidental to the project as a whole and are not established as a primary income source for the individual owners of a condominium or cooperative unit.

The Commission recognizes the need for a degree of certainty in the real estate offering area and believes that the above guidelines will be helpful in assisting persons to comply with the securities laws. It is difficult, however, to anticipate the variety of arrangements that may accompany the offering of condominium projects. The Commission, therefore, would like to remind those engaged in the offering of condominiums or other interests in real estate with similar features that there may be situations, not referred to in this release, in which the offering of the interests constitutes an offering of securities. Whether an offering of securities is involved necessarily depends on the facts and circumstances of each particular case. The staff of the Commission will be available to respond to written inquiries on such matters.

[Release No. 33-5347. January 4, 1973, 38 F.R. 1735.]

APPENDIX G

Amicus Curiae Brief of Securities & Exchange Commission Filed in Connection With Rehearing *En Banc* in Ninth Circuit

United States Court Of Appeals For The Ninth Circuit

No. 85-1932

GERALD M. HOCKING,

Plaintiff-Appellant,

v.

MAYLEE DUBOIS and VITOUSEK & DICK REALTORS, INC.

Defendants-Appellees.

On Appeal from the United States District Court for the District of Nevada

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, ON REHEARING EN BANC

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United States Court Of Appeals For The Ninth Circuit

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GERALD M. HOCKING,

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MAYLEE DUBOIS AND VITOUSEK & DICK REALTORS, INC.

Defendants-Appellees.

On Appeal from the United States District Court for the District of Nevada

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, ON REHEARING EN BANC

STATEMENT OF THE ISSUE

Whether the sale of a condominium apartment, where the buyer may apply to participate in a rental pool managed by a company that has no affiliation or selling arrangement with the condominium seller, constitutes the sale of a security under the federal securities laws.

INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION AND SUMMARY OF ITS POSITION

The Securities and Exchange Commission, the agency principally responsible for the administration of the federal securities laws, submits this brief as amicus curiae to address an important question concerning the coverage of the federal securities laws. The Commission believes that the panel's decision in this case, which is being reheard en banc, improperly construed the reach of those laws in a case involving the sale of residential real estate. The Commission is particularly concerned because the panel reached its decision based in considerable part upon a misunderstanding of the Commission's position as stated in a 1973 Commission release.

This case concerns the resale of a condominium apartment in a resort complex in Hawaii. The developer of the complex had offered the original condominium purchasers the opportunity to participate in a rental pool. A rental pool is an arrangement whereby an agent is responsible for renting and managing all apartments that participate in the pool, and each owner receives a pro rata share of the rental income (less the agent's fee). A sale of a condominium by a developer who also provides a rental pool normally constitutes the sale of a security.

The resellers of the condominium here had chosen not to participate in the rental pool when they purchased their condominium from the developer. Nonetheless, in connection with the resale, a real estate agent informed the prospective buyer that the buyer could apply to participate in the pool. He subsequently applied and was accepted. The buyer sued the real estate agent and her employer under the federal securities laws for damages allegedly caused by fraudulent misrepresentations made by the agent relating, for the most part, to the value of the property. At issue is whether the sale of the condominium constituted the sale of a security. The panel concluded that the sale of a condominium as to which there exists an optional rental pool always constitutes the sale of an investment contract, and hence the sale of a security, even where, as appears to be the situation here,

there is no affiliation or selling arrangement between the condominium seller and the rental pool operator.

The Commission believes that neither the case law nor its 1973 release supports this conclusion. The investment contract test set forth in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), requires an investment of money in which profits will be obtained from the efforts of others. An investment of money in the purchase of a condominium is not, in itself, a securities transaction, nor is the independent procurement of management services from others. In this residential real estate transaction, we assume, based on our review of the record, that there was no affiliation or selling arrangement between the condominium seller or the real estate agent and the rental pool operator. As a result, the condominium sale and the pooling arrangements were two separate transactions, and the sale was not covered by the federal securities laws.

The panel determined that a Commission release published in 1973 (Securities Act Release No. 5347, 1 Fed. Sec. L. Rep. (CCH) para. 1049 (Jan. 4, 1973)), "compel[led]" its conclusion that the investment contract test was satisfied here. The Commission disagrees. That release applies to "*persons engaged in the business* of building and selling condominiums" who offer a rental pool "*coupled*" with a condominium. *Id.* at 2070 (emphasis added). In other words, the release was intended to apply to developers who, as is often the case in resort complex developments, make available a rental pool for condominium purchasers. The sellers here, by contrast, were not developers, and they could do, and did, nothing more than, acting through a real estate agent, inform the purchaser that an entity with which they had no affiliation or selling arrangement provided a rental pool. The release did not conclude that such a condominium sale is the sale of a security.

STATEMENT OF THE CASE

A. Facts[1]

The plaintiff, Gerald Hocking, a Nevada resident, purchased a condominium apartment from Tovik and Yaacov Liberman, who are not parties to this suit, through defendant Maylee Dubois, a licensed real estate agent. At the time, Dubois was employed by defendant Vitousek & Dick Realtors, Inc., a Hawaii real estate agency. The condominium was located in a Hawaiian resort complex developed by Aetna Life Insurance Company. As part of the original development, Aetna offered purchasers the opportunity to participate in a rental pool arrangement. The rental pool, which was managed by the Hotel Corporation of the Pacific, was optional, and the Libermans had elected not to participate.

In urging Hocking's purchase, Dubois told him of the availability of the rental pool arrangement. The purchase of the condominium gave Hocking the right to apply to the pool operator to participate in the rental pool. Hocking applied, and his application was accepted approximately two weeks after he purchased the condominium. The rental pool arrangement was to take effect six months later.

B. District Court Proceedings

Hocking filed suit in the United States District Court for the District of Nevada against the real estate agent, Dubois, and her employer, Vitousek & Dick Realtors, Inc. He alleged misrepresentations by Dubois relating for the most part to the value of the condominium, and sought recovery under the antifraud provisions of Sections 12 and 17 of the Securities Act of 1933, 15 U.S.C. 771 and 77q, and of Section 10(b) of the Securities Exchange Act of 1934 and Rule lOb-5 thereunder, 15 U.S.C. 78j(b) and 17 C.F.R. 240.10b-5. He also asserted certain state law claims.

The district court entered summary judgment in favor of the defendants on the securities law claims, and dismissed

[1] The statement of facts is taken from the opinion of the court of appeals.

the pendent state claims for lack of subject matter jurisdiction. The court based its decision on its conclusion that the sale of the condominium did not involve the sale of a security. Hocking had argued that the offer of a rental pool made the condominium sale an investment contract. The court, however, stated that "the mere representations by the defendants that there was a rental pooling agreement available which the plaintiff could enter into if he saw fit to do so subsequent to purchasing the property, is insufficient to establish a cause of action against these named defendants." (Appellant's Excerpts from Record on Appeal at 44).

C. **The Panel Decision of this Court**

Hocking appealed the district court ruling, and a divided panel of this Court reversed and remanded for further proceedings (839 F.2d 560). The panel held that if Hocking's allegation that the real estate agent had offered him the option to participate in the rental pool was true, the sale of the condominium satisfies the criteria for an investment contract set forth in Howey and its progeny.

The panel based its decision, in considerable part, on its interpretation of Securities Act Release No. 5347, 1 Fed. Sec. L. Rep. (CCH) para. 1049 (Jan. 4, 1973), in which the Commission set forth guidelines as to the application of the investment contract test to the offer and sale of condominium units. The panel noted that Release 5347 described three rental arrangements, one of which involves a rental pool. As to such an arrangement, the release states that "the offering of participation in a rental pool arrangement" brings the transaction within the scope of the investment contract test. *Id.* at 2072. The panel, in view of the release, stated that offering a condominium with a rental pool "*automatically* makes the investment a security." 839 F.2d at 565 (emphasis in original).

The panel went on to hold that, even apart from the release, the offer of the condominium satisfied the *Howey* test, which requires that there be an "(1) an investment of money, (2) in a common enterprise, (3) with the expectation of profits produced by the efforts of others." *Id.* at 564. The

panel analyzed each of these factors. First, the sale of the apartment involved an "investment of money." *Id.* at 566. Second, a rental pool involves a "common enterprise," because "the success of each participant's individual investment clearly depends on the entire [rental pool's] success." *Id.* at 567. Finally, an "expectation of profits produced by the efforts of others" exists "*whenever* a condominium is sold with [a rental pool] option." *Id.* (emphasis in original). The panel therefore remanded the case to the district court to determine whether Hocking was, as he alleged, offered an "option" to participate in a rental pool. *Id.* at 562 n.1.

In a dissenting opinion, Judge Hug concluded that the transaction did not involve the sale of a security because the seller had "no connection whatsoever with a rental pool." 839 F.2d at 572. In addition, Judge Hug stated that the majority's conclusion is based on its incorrect premise that Hocking was offered an "option" to participate in the rental pool. He stated that there is "no evidence in the record that even suggests an option was offered," and the seller did not even have a "transferable 'option' to enter the rental pool that was binding on the developer * * *." *Id.* (emphasis in original).

The defendants petitioned for rehearing *en banc*. This Court granted the petition on August 1, 1988.

ARGUMENT

THE SALE OF A CONDOMINIUM APARTMENT DOES NOT CONSTITUTE THE SALE OF A SECURITY UNDER THE FEDERAL SECURITIES LAWS WHERE THE SELLER HAS NO AFFILIATION OR SELLING ARRANGEMENT WITH THE RENTAL POOL OPERATOR.

A. Unless there is an affiliation or selling arrangement between the seller of a condominium and the rental pool operator, the condominium sale and the procurement of management services are two separate trans-

actions, and the condominium sale does not *satisfy the Howey investment contract test.*

Section 2(1) of the Securities Act, 15 U.S.C. 77b(1), and Section 3(a)(10) of the Securities Exchange Act, 15 U.S.C. 78c(a)(10), both define "security" as including "investment contract." The leading case on the meaning of "investment contract" is *Howey*, which defined an investment contract as "a contract, transaction or scheme whereby a person [1] invests his money [2] in a common enterprise and [3] is led to expect profits solely from the efforts of the promoter or a third party." 328 U.S. at 298-99.[2] When real property is sold as a residence or without management services, the transaction ordinarily does not involve the sale of a security. *See, e.g., United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975) (sale of cooperative apartments by nonprofit corporation, where purchasers sought to acquire a place to live, does not involve sale of a security); *Joyce v. Ritchie Tower Properties*, 417 F. Supp 53 (N.D. Ill. 1976) (condominium to be occupied by buyer as his residence); *Dumbarton Condominium Assoc. v. 3120 R Street Assoc.*, 657 F. Supp. 226 (D.D.C. 1987) (seller of condominium apartments did not promise to market, develop, sell, or lease the property on behalf of the buyers); *Mosher v. Southridge Assoc., Inc.*, 552 F. Supp. 1231 (W.D. Penn. 1982) (buyer had sole discretion whether or not to rent out condominium and no rental pool offered).

Where, however, real property is sold with management services, courts have found the investment contract test to have been satisfied when the management services were provided either by the real estate promoter or by an entity having some affiliation or selling arrangement with the promoter. *See, e.g., Howey*, 328 U.S. at 295 (promoter sells orange groves and company affiliated—under "direct

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[2] *See also United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975) (describing the third prong of the test as "a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others"); *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, 482 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973) (test is whether efforts made by those other than investors are the "undeniably significant ones").

common control"—with promoter offers to grow, harvest, and sell oranges); *Cameron v. Outdoor Resorts of America, Inc.*, 608 F.2d 187 (5th Cir. 1979) (promoter sells condominium campsites and retains exclusive right to rent campsites in owner's absence and share profits with owner); *Wooldridge Homes v. Bronze Tree*, 558 F. Supp. 1085 (D. Colo. 1983) (promoter sells unimproved resort property and promises to build condominiums and arrange for management services for two years); *Hodges v. H & R Investments*, 668 F. Supp 545 (N.D. Miss. 1987) (promoter of condominium guarantees buyer minimum rental income and promises to pay referral fee to buyer). As one commentator has noted, the typical situation that gives rise to an investment contract is the sale of property "accompanied by an arrangement under which the promoters * * * manage the entire operation and allocate the profits, if any, on the basis of the individual's relative participation." H. Bloomenthal, *Securities and Federal Corporate Law* (rev. ed. 1987), 2.04[1].

An affiliation or selling arrangement requirement stems from the nature of an investment contract. An investment contract requires both an investment of money and an expectation of profits from the efforts of others. An investment of money in the purchase of a condominium is not, in itself, a securities transaction, nor is the independent procurement of management services from others. Unless there is a link between the seller of the property (or his agent) and the provider of services, these are two separate transactions, and the property sale is not covered by the securities laws. *See Blackwell v. Bentsen*, 203 F.2d 690, 693 (5th Cir.), *cert. dismissed*, 347 U.S. 925 (1953) (finding an investment contract where the sales of citrus groves and the offering of management services, "although separate in form," "form constituent parts of what is essentially one transaction").

Since in this case there is no suggestion of any affiliation or selling arrangement between the sellers of the condominium (or the real estate agent) and the operator of the rental

pool, the sale of the condominium was not a transaction that involved an investment contract.[3]

B. Commission Release 5347, on which the panel relied in concluding that a security was sold here, applies to sales of condominiums by developers who have an affiliation or selling arrangement with a rental pool operator, not to a resale by an owner who has no such arrangement.

The Commission's view that the transaction at issue here did not involve the sale of a security is consistent with the position taken by the Commission in Release 5347. The release notes that "[t]he offer of real estate as such, without any collateral arrangements with the seller or others, does not involve the offer of a security." 1 Fed. Sec. L. Rep. (CCH) para. 1049 at 2071. However, the release states, "[w]hen the real estate is offered in conjunction with certain services, a security, in the form of an investment contract, may be present." *Id.* One such service noted in the release is a rental

---

[3] We are limiting our conclusion that there must be an affiliation or selling arrangement to the context of residential real estate, in light of its unique characteristic, noted in the case law, of providing a place to live (*see, e.g., United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975)). We are not expressing a view as to whether an affiliation or selling arrangement is necessary in all other types of cases, except to note that in other cases the management services must at least be "related" in some manner to the activities of the promoter. *See Bloomenthal, Securities and Federal Corporate Law*, (rev. ed. 1987) 2.04[11].

We also express no view as to who has the burden of proof on the linkage issue, or what will satisfy that burden so as to require the other side to go forward. We note, however, that it could be an easy evasion of the federal securities laws for a condominium seller and a rental pool operator to avoid formal documentary arrangements between themselves and nonetheless have an understanding, by custom and usage or otherwise.

pool.[4] The release does not state, however, that the mere contemporaneous offer of a rental pool is sufficient to meet the investment contract test. The very first sentence of the release makes clear that it applies where the condominium sale is "coupled with" the pool. *Id.* at 2070. Where the condominium seller and the rental pool operator have no affiliation or selling arrangement, there is no such "coupling."

Moreover, the release states that it applies to "persons engaged in the *business of building and selling* condominiums and similar types of real estate." *Id.* at 2070 (emphasis added). In other words, the release applies to developers, who, as is often the case in resort areas, have an affiliation or selling arrangement with a rental pool operator. The release does not apply to persons who resell their own individual units after the initial project is complete and have no such affiliation or selling arrangement with the pool operator.

The Commission's staff has expressed that understanding of the release on numerous occasions. Subsequent to the issuance of the Commission's release, persons involved in developing real estate projects have frequently sought the informal advice of the Commission's Division of Corporation Finance as to whether the Division would recommend Commission enforcement action if the property were sold without complying with the registration provisions of the Securities Act. The Division has declined to take a "no-action" position where there is an affiliation or selling arrangement between

---

[4] The release also discusses two other types of services that will cause an offering to be viewed as an offering of securities. The pertinent section of the release reads in full (1 Fed. Sec. L. Rep. (CCH) para. 1049 at 2072):

> In summary, the offering of condominium units in conjunction with any one of the following will cause the offering to be viewed as an offering of securities in the form of investment contracts:
>
> 1. The condominiums, with any rental arrangement or other similar service, are offered and sold with emphasis on the economic benefits to the purchaser to be derived from the managerial efforts of the promoter, or a third party designated or arranged for by the promoters, from rental of the units.
>
> 2. The offering of participation in a rental pool arrangement; and
>
> 3. The offering of a rental or similar arrangement whereby the purchaser must hold his unit available for rental for any part of the year, must use an exclusive rental agent or is otherwise materially restricted in his occupancy or rental of his unit.

the developer and the rental pool operator. *See, e.g., Little Squaw Mountain Township* (April 25, 1973) (rental pool operated by subsidiary of the developer); *Inter-Mack—Pali Ke Kua Condominiums* (March 29, 1974) (rental pool operated by agent employed by the developer). Where, however, no such affiliation or selling arrangement is present, the Division has taken a no-action position. *See Terrace Hills Condominium* (September 29, 1983) (optional rental pool available from the Board of Directors of the Homeowners Association, an entity that had no business relationship with the developer).[5]

[5] The only possible exception to this approach is *Embarcadero*, [1976-77] Fed. Sec. L. Rep. (CCH) para. 80,956 (Dec. 3, 1976), which the panel cited for the proposition that a condominium owner who participates in a rental pool cannot "uncouple" the condominium from the rental pool. *See* 839 F.2d at 570. There, the Division of Corporation Finance declined to take a no-action position as to a transaction involving the resale of a condominium in which participation in the original rental pool offered by the developer terminated upon resale and the new purchaser had to apply to enter the pool. The *Embarcadero* letter contains little discussion, and it cannot be determined whether there was an affiliation or selling arrangement between the seller of the condominium and the rental pool operator. Assuming there was no such relationship, *Embarcadero* is a statement of the staff in 1976 with which the present staff and the Commission disagree. *See* 17 C.F.R. 202.1(D) ("opinions expressed by members of the staff do not constitute an official expression of the Commission's views.")

CONCLUSION

For the foregoing reasons, the Commission believes that the availability of a condominium rental pool does not make the sale of the condominium a securities transaction where the condominium seller has no affiliation or selling arrangement with the rental pool operator.

Respectfully submitted,

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October 1988

APPENDIX H

Order dated August 1, 1988 by the Ninth Circuit that the Original Decision of the Court of Appeals be Reheard by the *En Banc* Court

FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

GERALD M. HOCKING, *Plaintiff-Appellant,* v. MAYLEE DUBOIS and VITOUSEK & DICK REALTORS, INC., a Hawaii corporation, *Defendants-Appellees.*	No. 85-1932 DC No. C-LV-83-835-HDM ORDER

Before: GOODWIN, Chief Judge, BROWNING, WALLACE, HUG, TANG, SCHROEDER, FLETCHER, FARRIS, PREGERSON, ALARCON, POOLE, NELSON, CANBY, NORRIS, REINHARDT, BEEZER, HALL, WIGGINS, BRUNETTI, KOZINSKI, NOONAN, THOMPSON, O'SCANNLAIN, LEAVY, and TROTT, Circuit Judges

Upon the vote of a majority of the nonrecused active judges of this court, it is ordered that this case be reheard by the en banc court pursuant to Circuit Rule 35-3.

Supreme Court, U.S.
FILED
MAR 15 1990
JOSEPH F. SPANIOL, JR.
CLERK

No. 89-1023

(2)

In The

Supreme Court of the United States

October Term, 1989

MAYLEE DUBOIS AND VITOUSEK & DICK REALTORS, INC.,

Petitioners,

v.

GERALD HOCKING,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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OPINION BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit sitting en banc is reported at 885 F.2d 1449 (9th Cir. 1989).

STATEMENT OF THE CASE

Introductory Statement

In this brief the respondent, Gerald Hocking ("Hocking" herein), will once again attempt to bring this case back down to earth by addressing the true facts of this particular case and applying those facts to existing law in order to demonstrate why the granting of the petition for writ of certiorari is both unnecessary and inappropriate.

The erroneous innuendos, omissions, and outright misstatements of the facts contained in the petition demand an accurate restatement of the relevant facts of this case, which immediately follows this introductory statement.

The appeal taken by Hocking as plaintiff was from a district court order granting the defendants' motion for summary judgment, in which the district court held that, although it was a close question, the subject transaction did not involve the offer and sale of an "investment contract" and, therefore, a "security" as defined under Section 2 of the Securities Act of 1933, as amended ("the Securities Act" herein), 15 U.S.C. § 77b(1), and Section 3 of the Securities Exchange Act of 1934, as amended ("the Exchange Act" herein), 15 U.S.C. § 78(a)(10). (See the

district court's memorandum decision, which is Appendix D to the petition.)

Since the appellate court is required to review the granting of summary judgment de novo and to view the evidence in the light most favorable to Hocking (as stated in the en banc Ninth Circuit panel opinion on page A-9 of Appendix A to the petition), it is important to note that the only testimonial evidence (in addition to documentary evidence) which is in evidence in this case and a part of the record on appeal is Hocking's affidavit, presented to the district court in opposition to the motion for summary judgment. Accordingly, a copy of that affidavit is included as Appendix I to this brief.

In furtherance of this Court having the true facts before it, a relevant portion of the actual rental pooling agreement which was in effect in this case and the addendum thereto, to both of which documents the petition makes reference without offering them, are also included as Appendix II and Appendix III, respectively, to this brief.

Statement of Facts

In late 1978 or early 1979 Hocking was contacted regarding an investment in Hawaii by petitioner Maylee Dubois ("Dubois" herein), who had been a resident of Nevada but who had become a licensed real estate agent in Hawaii employed by petitioner Vitousek and Dick Realtors, Inc. ("Vitousek and Dick" herein), a licensed real estate broker in Hawaii. Dubois proposed that Hocking purchase a condominium in Honolulu, Hawaii, for investment purposes, and, at the same time, also proposed that he enter into an agreement providing for a

rental pooling arrangement which was connected with the developer and which most if not all of the other condominium purchases in the same building had entered into also. The rental pooling arrangement ("RPA" herein) was part and parcel of the offer to Hocking to purchase the condominium and emphasized the economic benefits to be derived by Hocking from the managerial efforts of third parties designated and arranged for by Dubois from the rental of the condominium and participation in the RPA. Consequently, when Hocking agreed to make the investment, Dubois provided to him various documents for him to sign, including (1) a purchase and sale agreement dated June 23, 1979 to purchase the condominium, (2) a Rental Management Agreement dated July 5, 1979, which was superseded by (3) a so-called Individual Agency Rental Agreement also dated July 5, 1979 (Appendix II hereto), and (4) an Addendum thereto, which was executed by Hocking on July 21, 1979 (Appendix III hereto).

Hocking has emphatically stated that he would never have purchased the condominium without the RPA. (See Appendix I hereto, paragraph 3, page I-2.) He further stated that the RPA was handled by Dubois and the rental agent in Hawaii. (See Appendix I hereto, paragraph 3, page I-2.) Based on the representations of Dubois concerning income to be derived from the RPA, Hocking expected the rental income not only to cover his monthly payment on the purchase price of the condominium but also to provide him with additional income on his investment. (See Appendix I, paragraph 4, page I-2.) Hocking further stated that he knew and relied on the fact that some fifty other condominium owners in the same

building participated in the RPA (see Appendix I, paragraph 6, page I-6) and that, when he visited the condominium, he observed that the building in which it was located was operated like a hotel from the lobby by the RPA company with which Hocking had contracted (see Appendix I, paragraph 6, page I-6). Although all of Hocking's dealings concerning the condominium and the RPA were directly with or through Dubois, Hocking believed that he was purchasing the condominium as a first purchaser from the developer. While he later became aware that he was instead a secondary purchaser and was purchasing the condominium from an original purchaser, Hocking still believed that he was dealing with a RPA company provided by the developer. The linkage between the developer and the RPA company was confirmed when Hocking signed the Addendum to the RPA Agreement on or about July 21, 1979 (Appendix III hereto). After entering into the RPA Hocking relinquished control of the condominium to the RPA company (and had access to it for only two weeks per year). (See Appendix I, paragraph 6, page I-3.)

After losing his entire investment, on December 9, 1983 Hocking filed his complaint in the United States District Court for the District of Nevada against Dubois and her employer Vitousek and Dick. It was on Hocking's third amended complaint filed on February 13, 1985 that Dubois and Vitousek and Dick, on October 31, 1984, filed their joint motion for summary judgment, which was granted by the district court on March 20, 1985 (Appendix D to the petition). Hocking appealed to the United States Court of Appeals for the Ninth Circuit, which issued the original decision of its three-judge panel in *Hocking v. Dubois*, 839 F.2d 560 (9th Cir. 1988), reversing

and remanding the case (Appendix C to the petition). However, after considering a petition for an en banc rehearing of the appeal, on December 7, 1988, the original decision was withdrawn at 863 F.2d 564 (9th Cir. 1989) (Appendix B to the petition). Finally, on September 21, 1989, the en banc panel of the Ninth Circuit issued its decision at 885 F.2d 1449 (9th Cir. 1989), also reversing and remanding the case, from which the subject petition for writ of certiorari was taken.

REASONS FOR DENYING THE WRIT

The *Howey* Test Is Met.

Hocking has met all three requirements of the three-prong test set forth in *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946). First of all there obviously was an "investment of money." Secondly, the "pooling" aspects of the RPA provides the "common enterprise." And, thirdly, there was, on the part of Hocking, the "expectation of profits from the managerial efforts of others."

The petitioners urge that Hocking had the voluntary decision to do whatever he wanted with the condominium, thereby defeating the third prong of the *Howey* test. However, the facts of the instant case reveal that the realities were otherwise. Hocking could not afford to buy the condominium unless the income from the RPA at least covered his purchase payments, which they did not, so he ultimately lost his entire investment. (See Appendix I hereto.) The statement that Hocking was relying entirely on the appreciation of the value of the condominium for profits to be derived from the investment is entirely

incorrect, based on the facts as presented, which undisputedly the courts, both trial and appellate, are required to view most favorably to Hocking. What was offered to Hocking by the petitioners was that certain "bundle of goods" that gave him what he thought was a good investment which would produce passive income sufficient for him to continue to pay for it. Had it been offered to him otherwise, he would not have made the investment. (See Appendix I hereto.)

His anticipated (and misrepresented) profits were clearly to have been derived from the efforts of others. He had no real choice. The building in which the condominium was located was being run like a hotel by the same company with which Hocking and the other condominium owners had contracted their RPA. The economic realities were that Hocking either went along with the arrangement or he couldn't (and shouldn't) accept the investment offer made to him by Dubois. (See Appendix I hereto.)

The petitioners' contention, on page 20 of their petition, that "Hocking could terminate both the Rental Management Agreement and the Pooling Agreement on extremely short notice, and as such he could regain total control and unimpeded access to and use of his condominium," is erroneous and misleading. As stated above the so-called Rental Management Agreement was superseded by the so-called Pooling Agreement, so the former's termination provisions were also superseded by the latter and are irrelevant and inapplicable. The so-called Pooling Agreement, however, had no such short termination provision but could only be terminated on ninety days' notice prior to the anniversary date. After

the expiration of the first year of the term of the RPA agreement, Hocking had virtually no control over the condominium. (See Appendix II.)

The petitioners also argue that the purchase of the condominium and the entry into the RPA agreement were totally separate transactions and that there was no affiliation or linkage between them. This argument flies in the face of the facts presented by Hocking that the offer to him to purchase the condominium was tied to the RPA agreement, without which he would not have made the investment. (See Appendix I hereto.) Furthermore, the Addendum to the RPA agreement (Appendix III hereto) also supports Hocking's position by extending the time for the RPA agreement to take effect. The Addendum also supports Hocking's contention that he thought that he was purchasing directly from the developer, because the Addendum shows that the developer needed additional time to complete the building and all of the condominiums contained therein including the one purchased by Hocking.

The only other argument that could supply a reason for the Addendum is a nefarious one, namely that the developer and the RPA operator, obviously affiliated and linked together by mutual interest, if nothing else, wanted to provide an artificial space of time from which they could argue that their joint transactions did not involve the offer and sale of securities. However, in this case, as has been stated and restated herein, the facts presented must be viewed most favorably to Hocking. Accordingly, whichever argument may be accepted still leads to the same conclusion that the transactions in the case involved the offer and sale of a security.

The facts in this case offer no major departure from existing law under *Howey* and its progeny. Moreover, the en banc panel of the Ninth Circuit retreated from the "bright line rule" enunciated in the three-judge panel's decision and refused to state unequivocally that the "bundle of goods" offered and sold in this case was a security; rather, the majority held only that there were sufficient facts presented here where the district court could find that there was a security, not that the district court was required to do so after hearing the facts from both sides. Obviously, therefore, since this case has not yet been tried, consideration of it at this stage by the Supreme Court of the United States is premature.

The Ninth Circuit's Reasoning Is Sound.

Even if the majority decision of the Ninth Circuit en banc panel is viewed as expansive of *Howey* and the other cases decided under it in the various circuits and elsewhere, as contended, nevertheless, and for all of the good reasons stated above, the present reasoning of the Ninth Circuit on this issue is sound.

To differentiate between the sale of a condominium offered with an RPA when it is offered by the original developer rather than by a subsequent owner or by a broker has no sound reason. Neither does it make good sense to differentiate between the situation where the offerors and sellers of the condominium and the RPA are different and separate entities rather than the same one. To make such differentiations is the essence of "form over substance," which is precisely what the enactment of the securities laws, their regulation by the Securities and

Exchange Commission, and their interpretation by the Courts have sought to avoid. It is urged upon this Court that this is also precisely what the Ninth Circuit has done in the instant case, and its decision should be left undisturbed.

There Is No New Burden on the Real Estate Industry.

To characterize as an overstatement the position that the Ninth Circuit decision in the instant case creates a new burden on the real estate industry is itself an understatement.

The real estate industry, including both developers and brokers, have been on notice since 1973, when the Securities and Exchange Commission issued Securities Act Release No. 33-5347, 17 C.F.R. 231, 38 Fed. Reg. 1735, 1 Fed.Sec.L.Rep. (CCH) ¶ 1049 (Jan. 4, 1973), that it was necessary to be very careful with offering and selling real estate condominiums with rental pooling arrangements. The subject Ninth Circuit decision, which the petitioners seek to overturn, merely gives additional guidelines for real estate brokers to follow in order to prevent liability under the federal securities laws, which should be a help and not a hindrance to them.

To suggest that offers and sales which fit into the present Ninth Circuit guidelines will all have to be registered under the Securities Act is ludicrous. The petitioners and particularly their counsel of record well know that there are exemptions from registration of which advantage could be taken, involving relatively little cost in comparison to full registration costs. If the package which is being offered is a security, then it should be offered as

such, and, if it has to be sent by the real estate broker down the street to the neighborhood securities broker-dealer, then that is what the law requires, because, if the package is truly a security, then the prospective offeree-purchaser is entitled to the protection which the securities laws are supposed to provide.

CONCLUSION

The Ninth Circuit decision which the subject petition seeks to overturn is entirely consistent with *Howey* and its progeny and, in any event, is based on sound reasoning because, upon careful examination, it makes good sense and, therefore, good law. Moreover, the decision is only one which says that the district court erred in finding that the facts of this case could not involve the offer and sale of a security – not that there absolutely is a security present here. This case should now be considered by the district court under the standards enunciated by the Circuit Court; consequently, it is premature for the Supreme Court of the United States to hear this case at this time. Finally, the Ninth Circuit has put no new burden on the real estate industry by its scholarly decision. Accordingly, the petition for writ of certiorari should be denied.

Respectfully submitted,

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APPENDIX I

AFFIDAVIT OF GERALD M. HOCKING

STATE OF NEVADA)
) SS.
COUNTY OF CLARK)

I, GERALD M. HOCKING, being first duly sworn upon my oath, depose and state as follows:

1. I am the plaintiff in the above-captioned case, and I make this affidavit on my personal knowledge in opposition to Defendants [sic] Joint Motion for Summary Judgment.

2. When my deposition was taken on July 28, 1984, I had not reviewed the various documents which I have accumulated in connection with the above-captioned case. However, I have recently done so thoroughly. Thereafter, I also reread the transcript of my said deposition. The questions and answers therefrom quoted by the defendants in their so-called Statement of Material Facts in support of their motion for summary judgment are incomplete: in certain instances the obvious next question was not asked; I was not given the opportunity to explain my answers; and my attorney, in his discretion, did not choose to cross-examine me to provide additional information or such explanations.

3. When I testified in my deposition that I did not depend upon the company that provided the pooling arrangement to increase the value of the condominium, I only meant that I thought that the pooling arrangement

in and of itself would not affect the value of the condominium at resale. Whether the statement is in fact true I do not know. The fact is that I would never have entered into the transaction without the pooling arrangement, and I so testified in my deposition on page 62, lines 24-25, and page 63, lines 1-5:

> "There's one simple fact. Your question is could I have bought the place without a rental agreement. That is the question, but that question isn't complete in that would I have.
>
> "No I would not have. Could I have, yes, but as I bought it, it was understood to be handled by my agent and the company in Hawaii."

4. Similarly, I also testified that defendant Maylee DuBois did not make any representations as to how much rent I would expect to receive on a monthly basis. Again, it is accurate that she did not state a specific figure to me. However, as I also testified, she did tell me what I could expect on a daily basis and I so testified on page 27, lines 13-15:

> "As I remember, I was informed that those condominiums were renting anywhere from $80 to $100 to $110, average $100 a day."

It was simple arithmetic for me to calculate that the monthly income, based on the daily rental figures represented to me, would be $2,000-$3,000 per month. Again, while I did not expect my rental income from the pooling arrangement to increase the resale value of the condominium, I certainly did rely upon the expected rental income not only to cover the monthly payment on the purchase price but also to provide me with additional income.

5. The critical fact is – and I was never asked this question at my deposition – that the failure to receive the expected rental income which was represented to me resulted in the loss of my investment in the condominium. The reason is obvious: I had expected the rental income represented to me to at least cover my monthly payment, which it did not; even though it was represented to me that the resale value of the condominium was increasing, I finally discovered that it was not; and I could not afford to put any more money into the condominium. Specifically, defendant Maylee DuBois consistently told me throughout the period of my ownership of the condominium that it was appreciating in value; however, when I realized that I was not going to derive rental income, I listed the condominium for sale with defendant Maylee DuBois at the price she advised, namely $190,000, and I later found out both that the listing had never been effected and that the price was entirely too high.

6. I knew and relied upon the fact that approximately fifty other condominium owners participated in the pooling arrangement of which I was a part. The monthly statements which I received from the company operating the pooling arrangement indicated that I was receiving approximately 2% of the total rental income from the building each month. When I visited my condominium, I observed that the building in which it was located was operated like a hotel from the lobby, and I received copies of the brochures and advertisements which the pooling company distributed to the mainland. I relinquished control of the condominium to the pooling company right at the time I purchased it and only had access to it for not more than two weeks per year.

7. The contention by the defendants that I am a "sophisticated investor" is ridiculous. As I testified in my deposition, I am a high school graduate and have only the equivalent of one year of college. I have never taken any courses or had any special training whatsoever in investments or real estate or anything else for that matter. I knew nothing about tax free exchanges, and the proposal for the tax free exchange referred to by the defendants was one that was entirely laid out for me by a local real estate agent in Las Vegas, Nevada. I believe that the best evidence of my lack of sophistication is the fact that I accepted for such a substantial period of time the fraudulent misrepresentations of Maylee DuBois. The contracts that were presented to me by defendant Maylee DuBois and which I signed were represented to me to be standard forms that I neither read nor fully understood. In particular, the pooling agreements were printed forms, the terms and conditions of which I was given no opportunity to discuss or negotiate.

8. Defendants further contend that I have admitted that I could have sold the condominium for $135,000 and realized a profit from the purchase price of $115,000 at one point in time before the market price went down. Actually, my testimony in my deposition was as follows, on page 48, lines 4-9:

> "I remember her [defendant Maylee DuBois] telling me that it was a very good buy and at one time or another during the signing and such she had informed me it had already gone to $135,000 and holding onto it for a short time, keeping it rented out, and turning it around, I should realize a very nice profit from it."

I have absolutely no reason to believe that defendant Maylee DuBois' representation of the $135,000 figure at that time was accurate (any more than the inaccurate $190,000 figure that she related to me). Furthermore, she emphasized continuously that the value was steadily increasing and that I should not sell the condominium. I was only when I could not longer afford to put more money into the condominium that she agreed to list it (which she did not do), at which time she set the price of $190,000, knowing full well that the condominium could not be sold for what I had in it, let alone at a profit.

/s/ Gerald M. Hocking
GERALD M. HOCKING

SUBSCRIBED and SWORN to before me this 16 day of November, 1984.

/s/ S. Miller
S. MILLER

[SEAL]
Notary Public-State of Nevada
CLARK COUNTY
My Appointment Expires Jan. 17, 1987

APPENDIX II

2121 ALA WAI
INDIVIDUAL AGENCY RENTAL AGREEMENT
FOR POOLED OPERATION

THIS AGENCY RENTAL AGREEMENT is entered into this 5th day of July 1979, by and between Gerald M. Hocking (hereinafter referred to whether one or more persons or entities as "Owner"), and HOTEL CORPORATION OF THE PACIFIC, INC., a Hawaii corporation whose executive offices are located at 2299 Kuhio Avenue, Honolulu, Hawaii 96815 (hereinafter referred to as "Agent"). In consideration of the respective covenants and agreements herein contained, Owner and Agent herein agree as follows:

* * *

2. TERM

This Agreement shall become effective ___, 19 ___, and shall continue in full force and effect until MIDNIGHT, DECEMBER 31, 1984. Either party may elect to terminate this Agreement by giving written notice to the other party ninety (90) days prior to an anniversary date of this Agreement except that during the initial year Owner may elect to terminate at any time by giving written notice to Agent fifteen (15) days prior to date of intended termination. For the purpose of this Agreement an "anniversay date" shall be deemed to be JANUARY 1st. In the event this contract is terminated as provided herein, or the Unit sold during the term of this Agreement, Owner agrees that such termination or sale shall be subject to all confirmed rentals therefore arranged by

Agent and Owner agrees to advise Buyer of this Agreement during escrow. Agent, at his sole option, is hereby provided two (2) successive five (5) year extensions of this Agreement which may be exercised by Agent giving written notice to Owner six (6) months prior to the Agreement's then expiration date.

This Agreement will terminate if 75% of Owners then participating in Agent's program at Property elect (one vote per unit) to do so and that the Rental Advisory Committee provide to Agent written notice to such election one hundred twenty (120) days in advance of date of intended termination. Agent shall have the right to terminate after six (6) months from the inception of Agent's program at Property, should the number of units participating in Agent's program fall below 40% of all units in Property.

* * *

IN WITNESS WHEREOF, the parties hereto have executed this Agreement the day and year first above written.

Executed the Date above written:

By /s/ [Illegible]
HOTEL CORPORATION
OF THE PACIFIC

By /s/ Gerald M. Hocking
OWNER

By_____
OWNER

APPENDIX III

ADDENDUM TO 2121 ALA WAI INDIVIDUAL RENTAL AGENCY AGREEMENT FOR POOLED OPERATION

Consistent with the Developer of 2121 Ala Wai's original sales covenants, particularly Paragraph 23 of the Developer's Sales Agreement, Owner and Agent agree to waive all aspects of this Agreement with respect to pooling or sharing of expenses with other units in Property until which time the Developer has closed the sale of all units in the Property or until December 31, 1982, whichever shall occur first.

During such interim period Owner shall have no claim to any income from the rental of any unit other than his own; nor shall any other unit owner have any claim to any income from the rental of Owner's Unit. Agent shall distribute to Owner the net income of the Unit for the preceding calendar month together with the monthly operating statement. The monthly net income of the Unit shall be determined by deducting from the gross receipts of the Unit, the Agent's fees, any applicable travel agent's fee, and an amount, initially set at 25% of the gross income, which is estimated to be sufficient to cover all operating expenses and such reasonable sums as the Agent may reasonably deem necessary or appropriate to retain as reserves to meet abligations [sic] which will or may become due thereafter, taking into account estimated future income. As operating experience is gained, this 25% figure will be adjusted upwards or downwards by the Agent to insure that there will be no deficit or unreasonable surplus.

IN WITNESS WHEREOF, the parties hereto have executed this Addendum.

By /s/ [Illegible]
HOTEL CORPORATION
OR [sic] THE PAFCIFIC

date 7/31/79

By /s/ Gerald M. Hocking
OWNER

By /s/ Unit 2603
OWNER

date 7/21/79

(3)

Supreme Court, U.S.
FILED
MAR 27 1990
JOSEPH F. SPANIOL, JR.
CLERK

No. 89-1023

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1989

MAYLEE DUBOIS and VITOUSEK & DICK REALTORS, INC., Petitioners

v.

GERALD HOCKING, Respondent

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITIONER'S REPLY BRIEF

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MAYLEE DUBOIS and VITOUSEK & DICK REALTORS, INC.,
Petitioners

v.

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ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT
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PETITIONER'S REPLY BRIEF

First and foremost, it is important to highlight that Respondent Gerald Hocking *("Hocking")*, in his Brief in Opposition (the *"Opposition"*), has not challenged or denied several of the important and substantial reasons favoring the grant of a writ of certiorari in this case as explained by Petitioners in their Petition for a Writ of Certiorari (the *"Petition"*). Rather, Hocking has attempted to misfocus this Court's attention and obfuscate matters by very seriously misstating the undisputed facts and then analyzing the misstated facts, instead of addressing whether proper and substantial reasons exist in this case for granting a writ of certiorari.

Petitioners have set forth six substantial reasons in their Petition for granting a writ of certiorari in this case, including: (a) the deep division between the majority and two dissenting opinions in the Ninth Circuit's *en banc* panel decision, and the creation of a new test by the majority for determining whether a security exists, despite the absence of precedence therefor; (b) the majority's very serious misinterpretation of, and hence creation of conflict with, the Fifth Circuit's decision in *Blackwell v. Bentsen*, 203 F.2d 690 (5th Cir.), *cert.*

dismissed, 347 U.S. 925 (1953); (c) the significant conflict between the majority's opinion, on the one hand, and the opinions of several important Federal appellate and two district court decisions, on the other hand; and, (d) a total conflict between the majority's opinion and the views, interpretations and positions of the Securities & Exchange Commission *("SEC")* in this case.

Inasmuch as Hocking's Opposition does not challenge or deny the importance or substantiality of most of the reasons advocated by Petitioners for granting a writ of certiorari, but instead Hocking seriously distorts the simple undisputed facts of this case, Petitioners will briefly address and correct the more serious misstatements in the Opposition (in addition to addressing the two weak and misleading arguments put forth by Hocking as to why certiorari should not be granted):

1. It was Hocking who sought the assistance of Petitioners to find him a condominium in Hawaii, as contrasted with Hocking's false assertion at page 2 of the Opposition that Petitioners sought him out (Record on Appeal *("ROA")* to the Ninth Circuit, pp. 63, 68 and 76). In addition, there is nothing in the record supporting Hocking's false assertion that Petitioner Maylee Dubois *("Ms. Dubois")* proposed that Hocking purchase the condominium "for investment purposes," or that she proposed that he enter into a rental pooling arrangement *("RPA")* with respect to the condominium. On the contrary, the record indicates that Ms. Dubois merely ***informed Hocking of the existence of an RPA.*** (ROA, pp. 69, 70 and 87.) There is no dispute that she had no right or authority to ***offer,*** and that she did not ***offer,*** Hocking any right to participate in an RPA.

Hocking's contention that he was offered a "bundle of goods" consisting of both the condominium and the RPA is contrary to the undisputed facts of this case which show an absence of any connection or relationship whatsoever between the sellers (the Libermans) or Petitioners, on the one hand, and Hotel Corporation of the Pacific, Ltd., the rental pool operator *("HCP"),* on the other hand. As such, neither

the Libermans nor Petitioners had the authority, power or right to offer anything to Hocking insofar as the RPA was concerned—only HCP had such ability. All that happened here was that Petitioners ***advised Hocking of the availability of a rental service operated by an unrelated third party.*** The dissenting opinions in the *en banc* decision emphasized that the Libermans and Petitioners had nothing to offer insofar as the RPA was concerned, and therefore did not offer to Hocking the one and only element—i.e., the RPA—that gives rise to the securities issue in this case.

In addition, Hocking misleadingly attempts to transform the fact that Ms. Dubois ***informed him of the availability*** of a rental service into the false contention that the RPA was "part and parcel of the offer to Hocking to purchase the condominium. . . . " (Opposition at p. 3.) The true and undisputed facts are that the RPA was offered by HCP, which had ***no affiliation or selling arrangement with the sellers of the condominium or Petitioners.*** Two different commodities were offered by two different sets of parties who were not affiliated with one another.

One of the important reasons contended by Petitioners, and the primary reason asserted by the SEC, for the proposition that an ***investment contract*** is not present in this case insofar as the ***offer and sale of the condominium are concerned*** is that there was ***no affiliation or selling arrangement between the sellers*** of the condominium ***or Petitioners*** (sellers' agent), on the one hand, and HCP, on the other hand. It is the absence of such a linkage that is fatal to Hocking's case, and is perhaps the paramount legal issue in this case.

2. Hocking states falsely that the RPA "was connected with the developer" (Opposition at p. 3), and that while it is true he learned he was purchasing the condominium from a secondary purchaser rather than the developer, he "still believed that he was dealing with a RPA company provided by the developer." (Opposition at p. 4.) The record is completely devoid of any basis for these statements.

Moreover, Hocking's argument at page 7 of the Opposition to the effect that the Addendum to the RPA signed on

or about July 21, 1979 (Appendix III to the Opposition) somehow supports his contention that he thought he was purchasing directly from the developer is contradicted by his own statement at page 4 of the Opposition where he admits that he "became aware that he was instead a secondary purchaser and was purchasing the condominium from an original purchaser." This gross contradiction by Hocking is but an example of the extent to which he has gone in misstating the facts and attempting to obfuscate matters in this case.

In addition, contrary to Hocking's false assertion, there is no evidence whatsoever in the record to suggest any involvement by the developer in connection with Hocking's purchase of the condominium. In this regard, Hocking's own deposition testimony contained in the Record on Appeal to the Ninth Circuit contradicts this assertion:

> "Q. Did anyone from Aetna Life Insurance [the original developer of the condominium complex] or whoever you found to be the true owners that were building the place approach you and promote you, promote the sale of the condominium to you?
>
> "A. No." (ROA, p. 82.)
>
> * * *
>
> "Q. Do you have any reason to believe that Maylee [Dubois] or Vitousek & Dick Realtors were connected in any way with the builders and promoters of the condominium complex?
>
> "A. No." (ROA, p. 83.)

Hocking's further contention that the Addendum somehow confirmed a linkage ***between HCP and the developer*** is misleading and misses the score on several points. First, the paramount issue in this case is whether there was an affiliation or selling arrangement ***between the sellers of the condominium or Petitioners, on the one hand, and HCP, on the other hand—***

and on this score, the record is clear that there was nothing of the kind. (Contrary to Hocking's misleading argument, the issue in this case is ***not*** whether there was such a relationship ***between HCP and Aetna, the developer.)*** Second, it was not until ***after*** the parties filed their petitions for rehearing *en banc* with the Ninth Circuit that the Addendum to the RPA surfaced in this case for the very first time. Prior to that time, Hocking had not even produced or referred to it, and had acknowledged that the developer played no role in these transactions (although Hocking now argues in his Opposition that the Addendum led him to believe there was a linkage between HCP and the developer). Indeed, while Hocking attached a copy of the rental pooling agreement to his complaint in this case, he did not include the Addendum therewith.

Moreover, the Addendum indicates that the original agreement pursuant to which the developer sold the condominium (which sale by the developer predated, and was unrelated to and independent of, the resale of the condominium by the Libermans to Hocking) required that the Libermans waive all aspects of any future agreement to pool or share expenses with any other units in the condominium complex until the developer had closed the sale of all of the units in the complex or until December 31, 1982, whichever occurred first. The obvious intent of such a clause was an attempt to separate the developer from any future rental pool whatsoever relating to the property, not to bring the developer closer to it. Hocking contorts this simple fact into a contention that it evidenced a linkage between the developer and HCP (which contention, as explained above, is irrelevant in any event since the real issue in this case is whether ***a linkage existed between the sellers or Petitioners, on the one hand, and HCP, on the other).***

3. Hocking's contention at page 8 of his Opposition that there is no need to distinguish between a condominium offered with an RPA when it is offered by the original developer rather than by a subsequent owner or by a broker is both misleading and not relevant to this case. It is misleading because it implies that the RPA in this case

was offered by the "subsequent owner"—the Libermans—or Petitioners as brokers, when the undisputed facts reveal that: (a) the Libermans were not participants in the RPA, had no arrangements or dealings with HCP, and had no communication or contact with Hocking; and (b) Petitioners had no affiliation or selling arrangement with HCP. Hocking's contention is irrelevant because the issue which the argument attempts to deal with is whether there was a ***linkage between the sellers or Petitioners, on the one hand, and HCP, on the other hand;*** however, the undisputed facts show that there was no such linkage in this case.

Moreover, Hocking's argument that it makes no good sense to differentiate between the situation where the offerors and the sellers of the condominium and the RPA are different and separate entities rather than the same one flies in the face of the very essence and basis of the sharp differences in the three opinions comprising the Ninth Circuit's *en banc* decision as well as the strong views and opinions urged by the SEC in its *amicus* brief to the Ninth Circuit.

4. Hocking states at page 3 of his Opposition that he expected the rental income from his condominium to reach certain levels "[b]ased on the representations of Dubois concerning income to be derived from the RPA. . . ." In fact, however, Hocking swears in his own affidavit attached as Appendix I to the Opposition (¶ 4, at page I-2) "that defendant Maylee Dubois did not make any representations as to how much rent [Hocking] would expect to receive on a monthly basis. Again, it is accurate that she did not state a specific figure to me."

5. At page 6 of his Opposition, Hocking attempts to make light of the termination rights he had under the so-called "Pooling Agreement" (a copy of which is attached as Appendix II to the Opposition). However, Paragraph 2 of the Pooling Agreement stated in no uncertain terms that:

> "Either party may elect to terminate this Agreement by giving written notice to the other party ninety (90) days prior to an anniversary date of this Agreement except that during the initial year Owner

> may elect to terminate at any time by giving written notice to Agent fifteen (15) days prior to date of intended termination. For purposes of this Agreement an 'anniversary date' shall be deemed to be January 1st."

As explained in the Petition, this termination right is of major significance in this case because it gave Hocking the ability to take back control and use of his condominium on short notice, and hence negated the third prong of the investment contract test set out in *SEC v. W.J. Howey*, 328 U.S. 293, 66 S.Ct. 1100, 90 L.Ed. 1244 (1946).

6. It is apparent that Hocking does not fully understand the potential consequences of this case to the real estate industry. If the consequence of this case is that real estate transactions will be more easily transformed into securities transactions, the impact on the real estate industry will be dramatic, manyfold and in some cases devastating. Most significantly, persons desiring to sell real estate will not be allowed to advertise it in newspapers and the like (which is the conventional means of advertising real estate for sale) without first filing a registration statement with the SEC for such a public offering of securities. The registration process is extremely expensive and time-consuming, and in the great majority of cases will cost far more in money and time than is practical or sensible.

Secondly, real estate agents will have to be registered as securities brokers in order to participate in sales of such properties. This concern was addressed by the National Association of Realtors and the Hawaii Association of Realtors in their *amicus curiae* briefs filed in connection with the Ninth Circuit's *en banc* consideration of this case. In the words of Judge Norris, writing for the five dissenting members of the *en banc* panel:

> "The majority's test is so standardless that unwary realtors who do nothing more than advise prospective condominium purchasers about the availability and economics of an RPA will find themselves in federal court defending actions

brought under the federal securities laws on the authority of the decision in this case." *Hocking v. Dubois,* 885 F.2d 1449, 1465 n.11 (9th Cir. 1989) *(en banc).*

Petitioners respectfully submit that there are many valid and substantial reasons justifying the grant of a writ of certiorari in this case.

Respectfully submitted,

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